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CIVIL SERVICE PENSION REFORM ACT OF 1985

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 1527

TO AMEND TITLE 5, UNITED STATES CODE, TO ESTABLISH A NEW RETIREMENT AND DISABILITY PLAN FOR FEDERAL EMPLOYEES, POSTAL EMPLOYEES, AND MEMBERS OF CONGRESS, AND FOR OTHER PURPOSES

SEPTEMBER 9, 10, AND 11, 1985

Printed for the use of the Committee on Governmental Affairs

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CIVIL SERVICE PENSION REFORM ACT OF 1985

MONDAY, SEPTEMBER 9, 1985

U.S. Senate,
Committee on Governmental Affairs,
Washington, DC.

The committee met at 10 a.m., in room SD-106, Dirksen Senate Office Building, Hon. Ted Stevens presiding.

Present: Senators Stevens, Eagleton, Glenn, and Gore.

Senator Stevens. Good morning.

Before we proceed any further I would like to place Chairman Roth's opening statement in the record at this point.

[Opening statement of Chairman Roth follows:]

Opening Statement of Chairman Roth

As the Committee on Governmental Affairs begins hearings on S. 1527, the new supplemental retirement plan for Federal workers, I would like to remind my colleagues of the important task that we have before us and urge that we move quickly in our deliberations.

This new retirement plan sponsored by Senator Stevens and myself is one of the major pieces of legislation that the 99th Congress will enact, and the system we envision may become a model for other pension systems, that provide supplemental benefits to Social Security.

This bill is necessary because the Congress required that all Federal employees hired after December 1983 and all Members of Congress participate in the Social Security program. This decision makes it necessary that a new retirement plan be developed that will fit with social security.

S. 1527 is the result of many months of research, and discussions by several members of the Governmental Affairs Committee and the administration in attempts to develop a bipartisan proposal for the new system. While we have not been able to achieve the goal of a bipartisan proposal, the legislation provides a solid retirement plan to supplement Social Security. It is important that we proceed quickly with its enactment. Time is running out. At the end of this year, the interim plan for workers hired since January 1984 will expire. If Congress fails to act, these people and the Government will be required to pay for both Social Security and the costs of the current retirement system. Costs to the employee would be staggering. Excessive costs—some 14 percent of a paycheck would go to retirement—resulting in overlapping and duplicative coverage.

That is why Senator Stevens and I feel it is our responsibility to move this legislation now. It is our good faith effort to keep our commitment to those workers, who are paying into Social Security under the 1983 act, and also contributing 1.3 percent of salary to the pension fund.

Even if the Social Security Amendments of 1983 had not mandated a new retirement system for workers hired after December 1983, I believe it would be time for Congress to design a modern pension system for Federal employees. Why should the civil servant be locked into an archaic retirement plan while his counterpart in the private sector or State government participates in plans that provide both retirement security and career flexibility? The Federal worker competes in the job market with the rest of the labor force. It is unfair to have his or her career opportunities limited by the conditions of the current pension system.

We are all aware of the shortcomings of the present retirement system. It favors the older career employee over the younger one, it makes mobility between the public and private sector difficult, it is poorly financed and it is too expensive. Our legislation eliminates the shortcomings of the current system, provides a sound basic benefit package similar to the private sector and allows employees to direct their income where it best suits their needs.

Let me say at the very beginning that this plan, because it deals with people who will retire many years from now, does not reduce the deficit. Certainly costs were a major factor in our work. We did not, however, contain costs by simply looking at the old plan, taking out the expensive parts and then deciding that whatever was left should be the new retirement system. This plan reflects the best of current practice. It has a long-range cost, expressed as a percentage of payroll, of 20.8 percent, which is about the same as a private pension plan for a large private organization. Our thrift plan contains features that will put Federal employees' benefits on an equal basis with the best private pension plans. In fact, we think our new system will be so attractive to Federal workers that we have included a transfer provision allowing individuals in the current system to enter the new plan.

Our new program is composed of three basic parts. The first is Social Security which workers will continue to pay into according to the payroll deduction schedules set out in the law.

Supplementing the basic Social Security benefit is the Second tier of our plan, a defined benefit pension very similar in structure to the present retirement system. Employees, however, make no contributions to this plan. The full cost of the plan is borne by the employer as is done in private industry. Employees vest for a benefit after 5 years of service and are eligible to retire with unreduced benefits at age 62, the same age as Social Security and the typical age for private industry.

This benefit is adjusted for inflation using an annual cost-of-living adjustment (COLA) based on the Consumer Price Index increase minus 2 percentage points. While this differs from the current plan, we must remember that most private pensions do not grant regular COLA's. By combining this partial automatic adjustment with the full COLA of Social Security and the investment opportunities under the thrift plan, the legislation provides inflation protection necessary to protect an employee's post-retirement standard of living.

The early retirement provisions break important new ground by permitting employees much wider choice about when they can retire with reduced benefits in a way that adds nothing to the long-range cost of the program, just as is done in private industry. We expect this feature to be especially popular with two-worker couples who wish to coordinate their plans as to retirement and possible career changes.

Disability benefits are coordinated with Social Security in our plan to provide income for the temporarily, as well as the long-termed disabled. Regardless of the type of impairment, entitlement for disability benefits begins after 18 months of service. Our objective here is to pay more adequate benefits to those who are truly disabled, and to encourge those able to return to work to do so.

The plan's survivors benefits are patterned after the private sector—a combination of Social Security, pension plan survivor benefits, thrift plan benefits and group life. However, here again we have borrowed on a better idea from private employers. Most employee benefit experts would argue that life insurance best protects young families. So, using the current Federal Employees Group Life Insurance, the Federal Government will now pay for all the basic coverage, while also giving employees the option to buy additional amounts.

The third and most innovative tier of our plan is the one I think will prove the most appealing to the Federal work force. This is our thrift plan, a concept that lets the worker take an active part in investing his money and tailoring his pension funds. The funds set aside may be used for survivor and disability purposes as well as retirement. Of course, this will mean greater responsibility and increased attention to changing investment patterns on the part of the worker. But private and State employees have managed these investments successfully for years, and we are aware of similar thrift options in the Federal Reserve Board pension system.

Our savings plan places the Federal retirement plan at the forefront of pension investment. Through the thrift plan, we intend to offer the employee a tax deferred savings plan in which the participant can yearly set aside up to 10 percent of his pay, with the first 5 percent matched by the Government and invested among a government bond fund, a fixed income fund or an equity fund.

This triad approach to investment strategy offers workers the opportunity to choose the amount of risk and prospective return appropriate for them. What is important is that this is the employee's choice. If, for financial or other reasons, the employee does not like the investments in one option, he or she may choose another.

This plan is fair and, except for a few technical occupations, it covers everyone the same including Congress and its employees. It is also solidly financed, with the money for benefits being set aside up front.

Before closing my remarks, I would like to acknowledge the excellent work and leadership of Senator Stevens, Chairman of the Civil Service, Post Office, and General Services Subcommittee, in bringing this proposal together. This legislation is a sophisticated proposal that represents many months of diligent and hard work.

In addition, the administration supports the structure and basic provisions of this bill. I am looking forward to their testimony along with the expert views of the witnesses that we will be hearing from in the coming days. It is my hope that after our examination, S. 1527 will have the support of all the Members so that we may proceed quickly to mark-up and passage of the bill before our December deadline. It is our responsibility not to let the new year begin without a pension plan for those who dedicate their careers to public service.

OPENING STATEMENT OF SENATOR STEVENS

Senator **Stevens**. Today we begin hearings on S. 1527, which is a bill establishing a new retirement program for the Federal Government. This bill as everyone knows, is the product of 4 years of work.

Some of us foresaw the inevitability of Social Security coverage for Federal employees before it actually happened and though we really opposed that, we wanted to be ready with a plan if it occurred. That is water under the bridge now. Social Security coverage of the new Federal work force forces us to redesign the retirement program of the Government to coordinate the Federal pension with the intricacies of the Social Security Program.

There is a time crunch now, whether we like it or not. Just prior to the date of the Social Security coverage of Federal employees, Congress enacted a 2-year interim retirement program to avoid having employees pay approximately 14 percent of salary and contributing to both Social Security and civil service retirement, and to afford us time to design a new retirement plan for the new employees.

The 2-year program expires at the end of this year. I do not feel it will be renewed. We are going to try and move this legislation out of the committee as quickly as possible. The bill before us establishes a three-tier retirement plan, utilizing existing Social Security as the base, with a defined benefit plan as the second tier and a tax deferred thrift plan serving as the final tier.

We have scheduled 2½ days of hearings—today, tomorrow, and Wednesday morning. Tuesday's and Wednesday's hearings will be in room 342 in this building.

Our first witness today is the Director of the Office of Personnel Management, Hon. Constance J. Horner.

TESTIMONY OF CONSTANCE J. HORNER, DIRECTOR, OFFICE OF PERSONNEL MANAGEMENT, ACCOMPANIED BY JAMES W. MORRISON, JR., ASSOCIATE DIRECTOR FOR COMPENSATION, OPM

Mrs. **Horner**. Good morning.

Mr. Chairman, I want to thank you for the opportunity to appear today to present the administration's views on S. 1527. I am accompanied by Mr. James Morrison, OPM's Associate Director for Compensation.

Mr. Chairman, I would like to preface my prepared testimony, which in the interest of time I will summarize, with some remarks on retirement objectives, if I may. Very brief remarks.

We face a momentous task here, to build a retirement system to take this Government and our employees into the next century. I can think of no better starting point than remarks by the President recently on tax reform. The President said, "Our fair share tax plan bears within the promise of more justice, more equity." I believe that S. 1527 fits that bill, it brings more opportunity, more diversity to our work force.

The President said that any tax reform package should keep our economy humming. Indeed, any Federal retirement system should keep our civil service humming, and most importantly, the President said of tax reform, "We are not Republicans and Democrats on this, we're Americans and we have got something to do for America."

I approach this task, as I know you do, with that sense of nonpartisanship.

The principal issue before us is neither the design nor cost of a new system but what kind of work force we want in the year 2030. My view is that we would be fortunate to have as fine a work force in the year 2030 as we do in 1985, but in order to do so, we need to recognize change. Our society is not only getting older, but more diverse, more mobile, and more financially literate.

Our retirement plan should recognize these demographic facts of the future.

Mr. Chairman, I would also like to compliment you and Senator Roth on the extraordinary, meticulous research, exhaustive consultation, and intellectual creativeness which went into the writing of this bill. Such an effort is reflective of the importance we all attach to it. The result is a bill which the administration can be very comfortable with. With a few, primarily technical changes, we expect to support it.

In the administration's view, the introduction of S. 1527 represents the most important and most positive step forward to date in the discussions of an appropriate new retirement system for those Federal employees who are covered by Social Security. Those of us who have gotten into this issue at all are very much aware of how complicated it is and S. 1527 does a very impressive job of addressing the myriad issues and concerns involved here.

The civil service pension system that would be established by this plan would be very similar to the better pension plans in the private sector and would meet the administration's objective of providing an appropriate level of retirement benefits for Federal employees at a reasonable cost. This new system would be carefully balanced to meet the needs of full career Federal employees for a secure and adequate retirement income, yet would also provide fair treatment for employees who remain with the Government for only a portion of their working lives.

We believe that a defined contribution element giving each employee the opportunity to make provision for his or her own retirement is one of the most attractive features of this new system.

The bill has been carefully crafted to address the special personnel management and fiscal management needs of the Government, yet brings to the Government the best practices of the private sector. A particularly good example of this is the long-term disability provision in the bill, where the benefit structure and careful meshing of the disability benefit with Social Security and with the rest of the pension plan will allow us to provide sound and adequate income protection for our disabled workers in a manner much more akin to the way other employers handle this sensitive issue.

We do have a few reservations about various aspects of the bill. I would like to address them very briefly.

One problem that we have to face in designing a government retirement system is the appropriate treatment for special categories of employees where a young and vigorous work force is needed, such as law enforcement officers, firefighters, and air traffic controllers. We believe certain important features of the current system meet these needs, and the bill needs to preserve these features by making retirement financially feasible at the current age and service requirements, by continuing mandatory retirement, and by continuing necessary coverage of supervisory and administrative positions.

Another provision that causes some concern is the requirement in the bill that the Department of Defense military retirement fund be liable for the cost of crediting military service under the civil service pension system. We think it would be administratively simpler to continue the current system of Treasury transfer payments to fund the cost of crediting military service as the benefits are paid.

We have strong reservations about the provision in the bill permitting crediting unused sick leave as service under the basic plan. Both the President's budget and the Grace Commission have called for eliminating this benefit from the current retirement system and we would hope that we can do so since this relatively minor benefit is quite costly and we believe this money could be used better to close some narrow and technical but serious gaps in the bill's disability and survivor protection.

S. 1527's provisions permitting the transfer of employees from the current retirement system to Social Security and the new civil service pension system appear on the whole to be reasonable and workable. But we are concerned about completely waiving the offset for employees who transfer. The windfall offset provisions of the Social Security Act were designed to reduce Social Security benefits that would otherwise be payable to those who spent a substantial portion of their working careers in employment that was sheltered from Social Security taxation, as Federal employment has been. By completely waiving the offset for employees who transfer, many long-service Federal employees who also qualify for Social Security benefits on the basis of minimal Social Security-covered employment could experience a substantial windfall, receiving much greater total benefits as a result of transferring to the new system than they could receive if they stayed under the current system. We believe the windfall offset must be retained, at least to some degree, for these people.

Finally, I would like to turn briefly to one of S. 1527's most interesting features, its thrift savings plan. This plan is very similar to, though not quite identical with, a 401(k) plan. As you know, the President's Tax Reform proposals, as recently amended, call for eliminating 401(k) plans. While we, therefore, object to including this 401(k) plan in S. 1527, we remain very much committed to the objective the thrift savings plan was trying to meet; namely, to encourage and assist employees to save for their own retirement in order to supplement their Social Security and basic plan benefits. We are examining alternatives and we hope to be able to propose to the committee shortly an approach that will both satisfy the important objectives of S. 1527's thrift savings plan and be consistent with the President's tax reform proposals.

Mr. Chairman, S. 1527 goes a long way toward meeting the needs of both the Federal work force of the future and the American taxpayer for a system that is cost conscious, that promotes the retention of seasoned employees, and that allows Federal employees security, mobility, and a major role in planning their own retirements.

I thank you for the opportunity to present these views and I am available for any questions you or other members may have.

Senator **Stevens**. Thank you very much.

I am pleased that we were able to make certain your appointment was confirmed before the recess so that you were able to study this issue and be with us here today. It is a significant contribution.

With regard to the decision of the administration on the 401(k), we had discussed that, and we look forward to your review. I am of the opinion that this is one portion of the President's tax reform proposal which is not going to meet with overwhelming support here on the Hill.

Could you tell me, in and discussions that you have had with the administration, did they indicate any willingness to accept the concept of deferred compensation as an incentive to increase savings?

Mrs. **Horner**. Well, Senator, in our initial discussions within the administration, our view was that, whatever the administration's tax plan ultimately contained, and whatever plan ultimately passed, the retirement plan ought to be in conformity with it. Since that time, in order to generate an additional $11.1 billion in revenues over 5 years, we have had to look to the 401(k) plans. We are very committed to the notion of a thrift plan. There are some ideas we are looking at that would involve deferral of taxation on the earnings of employees' investments. This would involve section 401(a) of the Tax Code. But at this time, I must say the administration is not accepting the concept of tax deferral for the basic investment.

Senator **Stevens**. The difficulty that we were trying to avoid by virtue of the third tier was the ever-escalating demand for COLA payments in periods of high inflation. That third tier being invested in the private sector under our plan would have given the employees protection against the violent swings of the economy and, therefore, would have represented an advance payment of really an insurance policy against the escalation of COLA's in a period of high inflation, as I indicated.

Are you looking at a similar solution for that problem?

Mrs. HORNER. Yes, Senator, we are. We haven't evaluated what degree of contribution the tax deferral on the employee contribution actually makes to the total financial outcome for that employee or for the system as a whole, but we are looking at a plan which would allow employee ownership which would allow tax deferral of earnings on contributions, and which would allow the employer match. I think that these provisions are the major provisions necessary, more important, perhaps, than tax deferral on the contributions.

Senator STEVENS. We expect testimony here today and tomorrow indicating that many people would rather have us not have the employer contribution to the thrift plan and instead increase the contribution to the pension plan and increase other benefits for the employee now. If that occurred, then we would have COLA's applying to the Social Security and COLA's applying to a larger pension plan and not have a third tier.

Mrs. HORNER. We would oppose that most strenuously, and entirely support the design of your plan. We think that the COLA incorporated in your plan is entirely appropriate and that it would be inappropriate to attempt to increase that COLA at the expense of the thrift plan. We would look forward to working with you to ensure that does not happen.

Senator STEVENS. I look forward to the results of your review. I hope you have a better crystal ball and series of computers than we have. The thrift plan was the best that we could find that would meet the objectives but, of course, it was tied directly to the 401(k). I presume as the employer, the Federal Government would create something which would reach the objectives of the 401(k), even if the 401(k) were removed.

Mrs. HORNER. That's our intention, Senator.

Senator STEVENS. You stated that the pension system established by this bill would compare favorably to better private sector plans. Have your people worked out what is the average cost of the private sector plans that you compared this to?

Mrs. HORNER. Yes, Mr. Chairman, we have, and if I may, I would like to have Mr. Morrison respond to that more fully, if you want a fuller response.

Senator STEVENS. We are happy to have Mr. Morrison with us again.

Mr. MORRISON. Mr. Chairman, on the average we find that the cost of private sector plan is about 17 percent and some of the better and richer plans are at 20 percent. So your proposal is clearly in that range and compares most favorably with even the better ones.

Senator STEVENS. Has the administration determined yet its position on the aspect of the bill that deals with private investment?

Mrs. HORNER. Senator, we support private investment unequivocally. We are still looking at the mechanics of the thrift investment board. We believe that the mechanics, as embodied in your bill, will achieve the goal of professionalism and investment detachment from political or other influence and a good rate of return for the Federal employee, thereby lessening the necessity of reliance on the defined benefit aspect of the plan. It is our view at this point that your bill does meet those needs very well but we are still studying it. It is tricky and requires further attention.

Senator STEVENS. Thank you.

You oppose transferring money from the military retirement fund to the civil service fund for those who probably will never receive a military pension. You want to have the Treasury subsidize the cost of crediting military service. I am one of those people who served for a period of time in the military and will use the service toward my civil service benefit.

Why would we do it the way you want to do it when we can use the military service toward civil service retirement at no cost to the employee?

Mrs. HORNER. Senator, for two reasons. First, is that many of those whose service is being credited would never have received military pensions, and second, because it is administratively much simpler to credit that service at the time of civilian employment retirement than to try to determine a lump sum for transfer at the time of entry into the civilian work force at the appropriate normal cost. It is just much simpler administratively and we think defensible theoretically to have the Treasury make the payments.

Senator STEVENS. It creates an automatic unfunded liability for the new system. It is one of the substantial problems of the old system; namely, the tremendous number of people in this country who have military service who will never become eligible for a military retirement payment who automatically become eligible for increased civilian pension payments under the system that you mentioned.

Our concept would be that at the time they become creditable, the military system would pay into the civilian system. You want it to be paid on an annual basis as to when it is needed, is that correct?

Mrs. HORNER. That's correct, Mr. Chairman.

Senator STEVENS. I hope you run some computers on that. With the number of people who have served in the military in this country from World War II, Korea, and Vietnam, in particular, who are eligible for that credit, it seems to me that is a horrendous unfunded liability for a new system to absorb.

Mrs. HORNER. Mr. Chairman, as you mentioned in your opening remarks, I am relatively new to this issue, and I will ascertain for my own sense of confidence in the administration's point of view what that liability might be.

Senator STEVENS. Let's just use my own experience as an example for you. I served in World War II for 3 years. Those 3 years of service were a few years ago, obviously, and I don't expect to make any demands on the civil service system for still a few more years. What it shows is the service that people put in at very young years, the very early years of their lives, and yet the liability for it carries over and is not paid by the Federal Government until retirement. Unless there is a contribution that is made at the time they become eligible for that transfer—in other words, at the time I became vested in the civil service retirement system, there should have been a payment. When I had 5 years and vested, they automatically credited the 3 years to my retirement account; there should have been a payment at that time. If the payment had been made at the point I vested in the civil service system, that money would have had increased earnings all through the period and would not have hit the Treasury with the heavy impact that it will if those 3 years are credited when I retire. We are just creating a problem for future generations by the administrations proposal to postpone accepting the liability for crediting that service. The liability occurs when you credit it after vesting occurs; and to do it at the time of retirement means that the unfunded liability for future generations is massive, whereas it's a liability that we can really handle under the current circumstances despite our financial difficulties. It would be much less expensive. I would urge you to restudy that because in my opinion, that would be a real criticism of the plan if the military credits are not funded at the time they become fixed under the new system.

I think most of the people who advised us felt very strongly about this, particularly now that we are crediting that portion to just one-third of the plan—not to Social Security, not to the third tier, but to the pension portion of the plan—and that pension portion of the plan will have a serious unfunded liability if we follow your recommendations.

My next question concerns sick leave credit. One of the reasons we permitted crediting of the annual sick leave under the basic plan was to encourage people not to take the sick leave. Your suggestion would, unfortunately, lead to a restoration of the old days when people just took their sick leave in order to burn it up. I see your friend shaking his head. Have you done some studies on that?

Mrs. Horner. Perhaps I should respond first and perhaps Mr. Morrison can add to that.

Mr. Chairman, perhaps in the old days, although I wouldn't want to say this for sure, attention to rigorous supervision of employees was not so heightened as it is now. I think that abuse of sick leave is a supervisory problem and it seems to me, because we are talking about abuse here by an employee, that it is the responsibility of the Federal managers to ensure that that abuse is caught, doesn't occur, is actively discouraged. The crediting of sick leave, I think, would cost $140 million a year under the new system. That is a consequential sum of money over time, or perhaps even in 1 year, from a certain perspective, and we think it is definitely worth a try to see if we can't save that amount of money and take care of the abuse problem, which you correctly identify, through supervisory improvements.

Senator Stevens. My memory is we did study it back at the time we changed the basic law, and we found that people felt it was a benefit to be used and they used it in a manner which was really additional annual leave rather than for sick leave.

Mr. Morrison, you disagree. Wasn't there a study back——

Mr. Morrison. I think the Senator is correct. There was a study. At that time we found the sick leave usage was about 8.5 days per employee. Now that we looked at it after it has been credited to the pension system, it is still 8.5 days. It has not been terribly effective in curtailing usage of sick leave. That is why we would recommend eliminating that credit and using the resources thus derived in a more productive way. It may be that we are crediting too many days of sick leave because of the unlimited carryover and we ought to perhaps work out some way to have a better accident and sickness benefit. That is a serious gap in the current system and not fully addressed in the Roth-Stevens——

Senator STEVENS. Are you studying those people only eligible for retirement benefits——

Mrs. HORNER. We looked at total sick leave usage for the Government and it is still 8.5 as it was before.

Senator STEVENS. I think that would probably be the case with the tremendous increase in the annual hires and the other people who are not becoming eligible for retirement benefits. I would like to see you study just those people eligible for retirement benefits and see how much sick leave they are using under the circumstances.

Mr. MORRISON. We will certainly try to look at that and see if there is any way we can make that kind of comparison. At the time the original study was done it was on the total work force and it was an effort to try to trim sick leave usage and these comparisons are basically comparable. We just find that overall sick leave usage has not been terribly affected by the inclusion of the credit in the retirement system.

[The information referred to follows:]

In 1969, sick leave usage per Federal employee was an average of 8.5 days. The sick leave credit for retirement took effect for retirements occurring on or after October 20, 1969. In 1970, sick leave usage per Federal employee went up slightly to an average of 8.7 days, and then increased to an average of 9.6 days in 1971. After reaching a peak of 9.8 days in 1972, average sick leave usage generally declined. In 1984, average sick leave usage was 8.5 days. Thus, there is no support for the view that the credit has reduced overall sick leave usage.

With respect to usage by employees nearing retirement, we do not have any data on which to make a comparison before and after enactment of the credit. We do have data for 1975, which shows that General Schedule employees used an average of 19.2 days of sick leave in the last 12 months before optional retirement. This compares to an average usage in 1975 of 11.9 days for General Schedule employees with at least 30 but not over 35 years of service, the length of service category with the highest average usage of sick leave, and to an average usage of 8.3 days for all General Schedule employees. In addition, a 1979 Comptroller General report found that at 5 Defense Department installations, sick leave usage averaged 34 days per employee in the 12 months preceding optional retirement. We believe that such figures indicate that sick leave usage is very high for employees nearing optional retirement, and while older employees might naturally be expected to use somewhat more sick leave than other employees, it does not appear that employees nearing optional retirement are making any special effort to conserve their sick leave.

In sum, the sick leave credit appears to have had no significant effect on overall sick leave usage, and does not appear to induce employees nearing retirement to conserve their sick leave.

Senator STEVENS. We raised everyone's retirement age and raised the law enforcement retirement age from 50 to 55. I happen to agree with your comment that law enforcement officers, firefighters, and air traffic controllers should be allowed to retire with 25 years of service at any age. I am not so sure about the 50 and 20 years. I think we will have to study that and make some comparison there because the great difficulty is that the retirement age for other employees is 62. If we have a substantial group of employees who can retire at 50 with 20 years, I think—and that is without any penalty—I think that will strain the system. I do understand your point about having younger people involved. It seems to me that 25 years of service ought to be sufficient.

Most of these people do in fact enter the Federal service in their early 20's, so it should not be that much different. Again, do you have any statistics on what would be the average retirement age of those people who have 25 years of service?

Mrs. Horner. Mr. Chairman, I will have to supply that to you.

Senator Stevens. It should not be much in excess of 50. I think the 25-year requirement is the figure that we ought to stand by and defend, not the 20 and 50. I would urge you to take a look at that again and submit to us some statistics to support your rationale that you would like to see us incorporate the 20–50. Would you do that, please?

Mrs. Horner. Yes, Mr. Chairman.

[The information referred to follows:]

09-Sep-85 Table R8 Special Provision Employee Annuitants On the Retirement Roll 1981 - 1984

Retirement Category	On Roll		Percent Men	Monthly Annuity		Contributions		Mean Years of Service			Age on 10/01/YEAR		Years On Roll		Percent with		
	Number	Percent		Mean	Median	Mean	Median	Military	Civilian	Total	Mean	Median	Mean	Median	FEGLI	Health Benefits	Survivor Election
Special Provision 1984																	
Law Enforce/Firefighters	19,506	1.4	98.0	2,005	1,853	18,417	16,878	2.2	27.2	29.4	63.9	63	9.1	8.1	98.4	95.4	85.8
Air Traffic Controllers	1,773	0.1	99.4	1,879	1,806	27,404	27,062	3.9	26.0	29.9	57.3	56	4.3	3.7	99.1	97.7	86.3
Members of Congress	373	.0	96.5	2,983	2,863	36,554	36,082	1.8	18.8	20.6	72.5	72	9.7	7.8	69.7	64.9	83.1
Other	5,218	0.4	77.0	849	687	11,799	7,759	0.8	27.1	27.9	65.8	62	5.0	4.3	87.8	86.3	60.5
Special Provision 1983																	
Law Enforce/Firefighters	19,081	1.4	98.0	2,008	1,847	17,790	16,291	2.2	27.3	29.5	63.5	62	8.6	7.5	98.3	95.7	86.0
Air Traffic Controllers	1,478	0.1	99.3	1,871	1,781	25,744	25,328	3.9	25.9	29.8	57.2	57	4.0	3.1	99.1	98.2	86.1
Members of Congress	378	.0	95.2	2,991	2,881	35,678	35,836	1.7	19.0	20.7	71.9	71	9.0	7.6	72.0	67.7	81.5
Other	3,821	0.3	81.7	893	745	13,237	9,728	1.0	28.7	29.7	59.1	59	3.0	3.5	94.9	85.4	70.2
Special Provision 1982																	
Law Enfor/Fire Fighters	18,488	1.4	98.1	1,959	1,798	17,338	15,802	2.2	27.4	29.6	63.1	62	8.0	6.8	98.6	96.3	86.8
Air Traffic Controllers	1,259	0.1	99.3	1,823	1,720	24,254	23,797	3.8	25.7	29.5	57.2	57	3.6	2.8	99.1	98.3	86.7
Members of Congress	373	.0	93.8	2,904	2,789	33,598	32,412	1.6	19.0	20.6	71.9	72	8.8	7.7	71.1	67.3	80.2
Other	4,915	0.4	74.4	774	624	9,591	5,998	0.7	26.7	27.4	68.5	62	4.5	2.7	82.6	90.4	55.7
Special Provision 1981																	
Law Enfor/Fire Fighters	17,827	1.3	98.2	1,817	1,668	16,788	15,211	2.1	27.6	29.7	62.8	61	7.5	6.3	98.5	96.6	87.1
Air Traffic Controllers	987	0.1	99.1	1,740	1,627	22,918	22,369	3.9	25.8	29.7	57.4	58	3.4	2.7	99.2	98.4	87.9
Members of Congress	391	.0	94.1	2,665	2,550	33,198	32,362	1.6	18.9	20.5	71.1	71	8.0	6.7	72.1	67.8	81.1
Other	4,658	0.4	74.7	689	552	8,320	5,079	0.5	26.3	26.8	70.8	63	4.6	2.0	78.3	93.4	52.3

Source: Annuity Roll
As Of Dates: October 1 of Year

09-Sep-85   Exhibit 67   Special Provision Employee Annuitants Added to the Retirement Roll During Fiscal Year 1981 - 1984

Retirement Category	Added to Roll		Percent Men	Monthly Annuity		Contributions		Mean Years of Service			Age at ACD		Percent with		
	Number	Percent		Mean	Median	Mean	Median	Military	Civilian	Total	Mean	Median	FEGLI	Health Benefits	Survivor Election
Special Provision 1984															
Law Enforce/Firefighters	868	1.0	98.0	1,739	1,714	29,312	28,220	2.5	25.3	27.8	53.7	53	98.3	94.5	87.9
Air Traffic Controllers	300	0.4	100.0	1,911	1,927	35,529	35,960	4.1	26.5	30.6	51.6	51	98.7	97.3	89.3
Members of Congress	11	.0	100.0	1,284	1,161	32,423	32,781	2.8	13.1	15.9	60.9	60	9.1	9.1	100.0
Other	457	0.5	80.3	1,023	921	19,036	17,462	1.4	27.2	28.6	56.3	57	94.5	85.8	70.0
Special Provision 1983															
Law Enforce/Firefighters	1,019	1.3	94.0	1,493	1,456	23,805	23,492	2.3	24.1	26.4	54.1	54	89.0	85.6	77.8
Air Traffic Controllers	243	0.3	99.6	1,777	1,781	32,931	33,072	4.0	26.7	30.7	51.7	50	98.8	98.8	84.8
Members of Congress	29	.0	100.0	2,379	2,395	53,338	62,376	2.7	19.0	21.7	62.7	62	79.3	75.9	89.7
Other	439	0.5	80.9	936	872	17,211	16,574	1.2	27.3	28.5	56.3	56	95.9	85.4	69.7
Special Provision 1982															
Law Enfor/Fire Fighters	1,041	1.2	98.1	1,581	1,475	24,665	23,113	2.8	24.9	27.7	53.5	53	98.5	95.1	87.7
Air Traffic Controller	286	0.3	100.0	1,575	1,570	28,837	29,226	3.9	25.1	29.0	52.1	50	98.6	98.2	84.6
Members of Congress	5	.0	80.0	1,572	1,770	40,850	45,317	2.3	12.8	15.1	59.4	60	20.0	20.0	100.0
Other	590	0.7	80.9	851	771	15,554	14,829	1.1	26.9	28.0	55.6	56	93.7	89.5	71.2
Special Provision 1981															
Law Enfor/Fire Fighters	1,242	1.0	98.1	1,660	1,538	23,814	22,113	2.6	26.1	28.7	53.2	53	99.3	96.7	89.6
Air Traffic Controllers	294	0.2	99.0	1,535	1,516	26,527	26,710	4.2	24.4	28.6	52.7	51	99.0	98.3	88.4
Members of Congress	54	.0	96.3	2,652	2,611	54,571	57,974	2.9	20.8	23.7	62.4	61	92.6	87.0	88.9
Other	1,390	1.1	78.7	935	838	15,505	14,711	1.3	27.9	29.2	56.0	56	95.2	90.3	72.5

Source: Annuity Roll
As Of Dates: October 1 of Year

Senator **Stevens**. Thank you very much. We appreciate your coming. I do appreciate your conversation with me about the other problems.

Mrs. **Horner**. Thank you very much, Mr. Chairman.

[Mrs. Horner's prepared statement follows:]

STATEMENT OF
HONORABLE CONSTANCE HORNER
DIRECTOR, OFFICE OF PERSONNEL MANAGEMENT

before the

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

at a hearing on

S. 1527, THE CIVIL SERVICE
PENSION REFORM ACT OF 1985

SEPTEMBER 9, 1985

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

THANK YOU FOR INVITING ME TO APPEAR TODAY TO DISCUSS S. 1527, THE CIVIL SERVICE PENSION REFORM ACT OF 1985.

IN THE ADMINISTRATION'S VIEW, THE INTRODUCTION OF S. 1527 REPRESENTS THE MOST IMPORTANT, AND MOST POSITIVE, STEP FORWARD TO DATE IN THE DISCUSSIONS OF AN APPROPRIATE NEW RETIREMENT SYSTEM FOR THOSE FEDERAL EMPLOYEES WHO ARE COVERED BY SOCIAL SECURITY. THOSE OF US WHO HAVE GOTTEN INTO THIS ISSUE AT ALL ARE VERY MUCH AWARE OF HOW COMPLICATED IT IS, AND S. 1527 DOES A VERY IMPRESSIVE JOB OF ADDRESSING THE MYRIAD ISSUES AND CONCERNS INVOLVED HERE.

THE CIVIL SERVICE PENSION SYSTEM THAT WOULD BE ESTABLISHED BY S. 1527 WOULD BE VERY SIMILAR TO THE BETTER PENSION PLANS IN THE PRIVATE SECTOR, AND WOULD MEET THE ADMINISTRATION'S OBJECTIVE OF PROVIDING AN APPROPRIATE LEVEL OF RETIREMENT BENEFITS FOR FEDERAL EMPLOYEES AT A REASONABLE COST. THIS NEW SYSTEM WOULD BE CAREFULLY BALANCED TO MEET THE NEEDS OF FULL-CAREER FEDERAL EMPLOYEES FOR A SECURE AND ADEQUATE RETIREMENT INCOME, YET WOULD ALSO PROVIDE FAIR TREATMENT FOR EMPLOYEES WHO REMAIN WITH THE GOVERNMENT FOR ONLY A PORTION OF THEIR WORKING LIVES.

BUILDING ON SOCIAL SECURITY AS A FOUNDATION, S. 1527 WOULD PROVIDE A BASIC LEVEL OF BENEFITS THROUGH A DEFINED BENEFIT PLAN AND THEN, AS CALLED FOR IN THE PRESIDENT'S BUDGET, WOULD INCLUDE A DEFINED CONTRIBUTION PLAN. WE BELIEVE THAT A DEFINED CONTRIBUTION ELEMENT, GIVING EACH EMPLOYEE THE OPPORTUNITY TO MAKE PROVISION FOR HIS OR HER OWN RETIREMENT, IS ONE OF THE MOST ATTRACTIVE FEATURES OF THE NEW SYSTEM.

THE BILL HAS BEEN CAREFULLY CRAFTED TO ADDRESS THE SPECIAL PERSONNEL MANAGEMENT AND FISCAL MANAGEMENT NEEDS OF THE GOVERNMENT, YET BRINGS TO THE GOVERNMENT THE BEST PRACTICES OF THE PRIVATE SECTOR. A PARTICULARLY GOOD EXAMPLE OF THIS IS THE LONG-TERM DISABILITY PROVISION IN THE BILL, WHERE THE BENEFIT STRUCTURE AND THE CAREFUL MESHING OF THE DISABILITY BENEFIT WITH SOCIAL SECURITY AND WITH THE REST OF THE PENSION PLAN WILL ALLOW US TO PROVIDE SOUND AND ADEQUATE INCOME PROTECTION FOR OUR DISABLED WORKERS IN A MANNER MUCH MORE AKIN TO THE WAY OTHER EMPLOYERS HANDLE THIS SENSITIVE ISSUE.

OF COURSE, ONE OF OUR MAJOR CONCERNS HAS TO BE THE COST OF THE NEW SYSTEM. THE CONGRESSIONAL RESEARCH SERVICE, USING SOCIAL SECURITY II-B ACTUARIAL ASSUMPTIONS, HAS ESTIMATED THAT THE EMPLOYER SHARE OF THE NORMAL COST OF THE CIVIL SERVICE PENSION SYSTEM WOULD BE 20.8 PERCENT OF PAYROLL. WE HAVE OUR OWN BOARD OF ACTUARIES ADVISING US AT OPM, AND THEY BELIEVE THAT SOMEWHAT MORE CONSERVATIVE ASSUMPTIONS ARE LIKELY TO PROVE MORE ACCURATE OVER THE LONG TERM, BUT EVEN USING

THE BOARD OF ACTUARIES ASSUMPTIONS, THE COST IS ESTIMATED TO BE ONLY A LITTLE HIGHER, 21.1 PERCENT OF PAYROLL. WHILE WE BELIEVE THE BOARD OF ACTUARIES ASSUMPTIONS ARE PROBABLY SOUNDER, THE COST BY EITHER MEASURE IS REASONABLY CLOSE TO THE PRESIDENT'S GOAL OF ABOUT 20 PERCENT OF PAYROLL, AND I HAVE NO OBJECTIONS TO USING THE CONGRESSIONAL RESEARCH SERVICE NUMBERS IN THESE DISCUSSIONS.

I WOULD NOW LIKE TO TURN TO A FEW RESERVATIONS WE DO HAVE ABOUT VARIOUS ASPECTS OF THE BILL, BUT BEFORE I DO SO, I WOULD LIKE TO EMPHASIZE THAT OUR SUGGESTIONS FOR CHANGES HERE SHOULD NOT BE TAKEN AS CALLING INTO QUESTION OUR STRONG SUPPORT FOR THE OVERALL APPROACH OF S. 1527.

AS IS INEVITABLE IN AN UNDERTAKING AS MASSIVE AND COMPLEX AS THIS, THERE ARE A GREAT MANY TECHNICAL DETAILS WHERE WE WOULD LIKE TO SEE MINOR CHANGES, AND I HOPE OUR STAFFS WILL BE ABLE TO WORK TOGETHER TO RESOLVE THESE MATTERS. I WOULD, HOWEVER, LIKE TO DISCUSS A FEW OF THE MORE SIGNIFICANT ISSUES.

ONE PROBLEM THAT WE HAVE TO FACE IN DESIGNING A GOVERNMENT RETIREMENT SYSTEM IS THE APPROPRIATE TREATMENT FOR CERTAIN SPECIAL CATEGORIES OF EMPLOYEES WHERE A YOUNG AND VIGOROUS WORK FORCE IS NEEDED, SUCH AS LAW ENFORCEMENT OFFICERS, FIREFIGHTERS, AND AIR TRAFFIC CONTROLLERS. S. 1527 HAS A NUMBER OF SPECIAL PROVISIONS DESIGNED TO PROVIDE FOR THESE EMPLOYEES. WE ARE PARTICULARLY PLEASED BY THE PROVISION THAT WILL CHARGE THE AGENCIES EMPLOYING THESE GROUPS FOR THEIR SPECIAL BENEFITS, RATHER THAN SPREADING THIS COST ACROSS THE WHOLE SYSTEM. HOWEVER, AS I HAVE DISCUSSED THE TREATMENT OF THESE GROUPS WITH MY COLLEAGUES IN

THE AGENCIES EMPLOYING THESE WORKERS, IT HAS BECOME APPARENT THAT THE BILL AS IT STANDS DOES NOT ADEQUATELY PRESERVE CERTAIN ESSENTIAL FEATURES OF THE CURRENT RETIREMENT SYSTEM FOR THESE EMPLOYEES.

WE BELIEVE THE BILL MUST BE CHANGED TO PROVIDE A REASONABLE LEVEL OF BENEFITS THAT WILL ALLOW THESE WORKERS TO RETIRE AT ANY AGE WITH 25 YEARS OF SERVICE, OR AT AGE 50 WITH 20 YEARS OF SERVICE. THE MANDATORY RETIREMENT PROVISIONS OF CURRENT LAW ARE ALSO ESSENTIAL TO THE MANAGEMENT OF THESE SPECIALIZED GROUPS, AND NEED TO BE RETAINED.

FINALLY, THE COVERAGE DEFINITIONS HAVE CAUSED CONCERN AMONG THE EMPLOYING AGENCIES. WE RECOGNIZE THAT THESE DEFINITIONS WERE DRAWN FROM AN EARLIER DISCUSSION DRAFT PREPARED BY OPM, BUT WE BELIEVE THEY NEED TO BE REEXAMINED. UNDER S. 1527, A LAW ENFORCEMENT OFFICER OR FIREFIGHTER WHO MOVES INTO A MANAGEMENT OR ADMINISTRATIVE JOB WOULD LOSE SPECIAL RETIREMENT COVERAGE. IT IS ESSENTIAL TO THE OPERATION OF THESE SPECIALIZED ACTIVITIES THAT WE CONTINUE TO BE ABLE TO RECRUIT MANAGERS FROM AMONG THE LINE WORKERS. ACCORDINGLY, WE THINK THAT THESE DEFINITIONS NEED TO BE CHANGED TO PERMIT MOVEMENT INTO THE MANAGERIAL RANKS, ALTHOUGH IT MIGHT BE POSSIBLE TO REQUIRE SOME MINIMUM PERIOD OF WORK IN THE BASIC COVERED POSITIONS.

ANOTHER PROVISION THAT CAUSES SOME CONCERN IS THE REQUIREMENT IN THE BILL THAT THE DEPARTMENT OF DEFENSE MILITARY RETIREMENT FUND BE LIABLE FOR THE COST OF CREDITING MILITARY SERVICE UNDER THE CIVIL SERVICE PENSION SYSTEM. WE DO NOT THINK THIS IS AN APPROPRIATE SOURCE FOR THIS MONEY, SINCE WHAT IS INVOLVED HERE IS NOT REALLY ANY SORT OF TRANSFER OF LIABILITY FROM ONE RETIREMENT SYSTEM TO ANOTHER, BUT INSTEAD MERELY THE CREDITING UNDER

OUR CIVILIAN SYSTEM OF MILITARY SERVICE OF PEOPLE WHO, FOR THE MOST PART, NEVER WOULD HAVE RECEIVED ANY PENSION FROM THE MILITARY SYSTEM ANYWAY. FURTHERMORE, IT WOULD BE VERY DIFFICULT TO DETERMINE THE SIZE OF THE LUMP-SUM NORMAL COST PAYMENTS THAT WOULD BE REQUIRED AT THE BEGINNING OF A VETERAN'S CIVILIAN CAREER. WE THINK IT WOULD BE MUCH PREFERABLE TO CONTINUE THE CURRENT SYSTEM OF TREASURY TRANSFER PAYMENTS TO FUND THE COST OF CREDITING MILITARY SERVICE AS THE BENEFITS ARE PAID.

WE HAVE STRONG RESERVATIONS ABOUT THE PROVISION IN THE BILL PERMITTING THE CREDITING OF UNUSED SICK LEAVE AS SERVICE UNDER THE BASIC PLAN. BOTH THE PRESIDENT'S BUDGET AND THE GRACE COMMISSION HAVE CALLED FOR ELIMINATING THIS ANOMALOUS AND ILLOGICAL BENEFIT FROM THE CURRENT RETIREMENT SYSTEM, AND WE WOULD HOPE THAT WE CAN AVOID SETTING THE NEW SYSTEM OFF ON THE WRONG FOOT IN THIS REGARD. THIS IS PARTICULARLY TRUE SINCE THIS RELATIVELY MINOR BENEFIT IS QUITE COSTLY, AND WE BELIEVE THIS MONEY COULD BE USED MUCH BETTER TO CLOSE SOME NARROW AND TECHNICAL, BUT SERIOUS, GAPS IN THE BILL'S DISABILITY AND SURVIVOR PROTECTIONS.

S. 1527'S PROVISIONS PERMITTING THE TRANSFER OF EMPLOYEES FROM THE CURRENT RETIREMENT SYSTEM TO SOCIAL SECURITY AND THE NEW CIVIL SERVICE PENSION SYSTEM APPEAR, ON THE WHOLE, TO BE REASONABLE AND WORKABLE, BUT WE ARE CONCERNED BY ONE ASPECT OF THESE PROVISIONS, NAMELY THE COMPLETE WAIVER OF THE SOCIAL SECURITY WINDFALL OFFSET PROVISIONS FOR EMPLOYEES WHO TRANSFER. THE WINDFALL OFFSET PROVISIONS OF THE SOCIAL SECURITY ACT WERE DESIGNED TO REDUCE SOCIAL SECURITY BENEFITS THAT WOULD OTHERWISE BE PAYABLE TO THOSE WHO SPENT A SUBSTANTIAL PORTION OF THEIR WORKING

CAREERS IN EMPLOYMENT THAT WAS SHELTERED FROM SOCIAL SECURITY TAXATION, AS FEDERAL EMPLOYMENT HAS BEEN. BY COMPLETELY WAIVING THE OFFSET FOR EMPLOYEES WHO TRANSFER, MANY LONG-SERVICE FEDERAL EMPLOYEES WHO ALSO QUALIFY FOR SOCIAL SECURITY BENEFITS ON THE BASIS OF MINIMAL SOCIAL SECURITY-COVERED EMPLOYMENT COULD EXPERIENCE A SUBSTANTIAL WINDFALL, RECEIVING MUCH GREATER TOTAL BENEFITS AS A RESULT OF TRANSFERRING TO THE NEW SYSTEM THAN THEY COULD RECEIVE IF THEY STAYED UNDER THE CURRENT SYSTEM. WE BELIEVE THE WINDFALL OFFSET MUST BE RETAINED, AT LEAST TO SOME DEGREE, FOR THESE PEOPLE.

FINALLY, I WOULD LIKE TO TURN BRIEFLY TO ONE OF S. 1527'S MOST INTERESTING FEATURES, ITS THRIFT SAVINGS PLAN. THIS PLAN IS VERY SIMILAR TO, THOUGH NOT QUITE IDENTICAL WITH, A 401(K) PLAN. AS YOU KNOW, THE PRESIDENT'S TAX REFORM PROPOSALS, AS RECENTLY AMENDED, CALL FOR ELIMINATING 401(K) PLANS. WHILE WE, THEREFORE, OBJECT TO INCLUDING THIS 401(K) PLAN IN S. 1527, WE REMAIN VERY MUCH COMMITTED TO THE OBJECTIVE THE THRIFT SAVINGS PLAN WAS TRYING TO MEET, NAMELY TO ENCOURAGE AND ASSIST EMPLOYEES TO SAVE FOR THEIR OWN RETIREMENT, IN ORDER TO SUPPLEMENT THEIR SOCIAL SECURITY AND BASIC PLAN BENEFITS. WE ARE EXAMINING ALTERNATIVES AND WE HOPE TO BE ABLE TO PROPOSE TO THE COMMITTEE SHORTLY AN APPROACH THAT WILL BOTH SATISFY THE IMPORTANT OBJECTIVES OF S. 1527'S THRIFT SAVINGS PLAN AND BE CONSISTENT WITH THE PRESIDENT'S TAX REFORM PROPOSALS.

THANK YOU AGAIN FOR THE OPPORTUNITY TO PRESENT THESE VIEWS. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Senator STEVENS. Mr. Charters, we will proceed with you now.

We are happy to have you with us, Mr. Charters. This is your first appearance as the Assistant Postmaster General for Employee Relations, and I understand you are accompanied by Thomas McCall, the General Manager for Compensation Services. Would you proceed, please?

TESTIMONY OF DAVID H. CHARTERS, ASSISTANT POSTMASTER GENERAL, EMPLOYEE RELATIONS DEPARTMENT, U.S. POSTAL SERVICE, ACCOMPANIED BY THOMAS S. McCALL, GENERAL MANAGER, COMPENSATION SERVICES DIVISION

Mr. CHARTERS. Thank you very much, Senator.

I am here today representing Paul Carlin, the Postmaster General. We appreciate very much the opportunity to testify and would like to begin with what we consider the four major ingredients for a good retirement program for postal employees. The program must be fair and actuarially sound; must be reasonably economical and fair to the postal rate payers who help finance it; must help to attract and retain the high quality employees we need to serve the public; and must generate sufficient predictable income for retirees to enjoy a reasonable standard of living.

The proposed bill, we believe, substantially contains the above ingredients.

We have estimated that the bill will cost the Postal Service almost 3.2 percent more than the Federal Employees Retirement Contribution Temporary Adjustment Act of 1983. For the first year following implementation, this will be approximately $114 million. We fully understand the reason for the additional expense, since this is a permanent solution replacing a temporary measure, but we feel it is necessary to highlight the financial impact this will have on our costs.

Our overall reaction to the bill is that it is a sound, well-constructed plan which should be attractive to new employees. While the bill offers the greatest benefits to long-term career employees, it will also provide retirement alternatives for employees seeking more flexibility. It provides portability through Social Security and the opportunity for a departing employee to withdraw his or her thrift account prior to retirement and roll it over into an IRA, thus never losing the value of that part of the plan.

We believe that any retirement program should have a defined benefit to allow employees to project, in advance of retirement, the level of retirement income they can expect, thereby providing the opportunity for the employee to decide if he or she needs or wants a larger return than that provided. The basic plan provides this needed defined benefit.

The replacement rate of an annuity should ideally be an amount sufficient to maintain the retiree's standard of living.

The replacement rate varies depending on the employee's level of income. Normally it will be in the range of 65 to 75 percent with the higher rate applicable to lower incomes. The current civil service retirement system does not provide this level of replacement until an employee has 35 or more years of service. The proposed bill provides the opportunity for an employee to achieve or even exceed the desired replacement rate through participation in a thrift savings plan.

We believe that an employee has an obligation, indeed a responsibility, to become involved in preparation for eventual retirement. We understand that OPM, as was mentioned earlier, is now considering various alternative approaches to the thrift plan provision of the bill, in view of the administration's recent recommendation to repeal 401(k). We are, nevertheless, committed to the thrift plan objective and believe some such plan must be an essential feature of the retirement package.

We believe the long-term disability benefit provided employees who are unable, due to sickness or injury, to perform the duties of their job is an excellent benefit that is not currently available. While injury compensation provides for those injured on the job, there is currently no corresponding protection for those whose illness or injury is not job related. This protection will be particularly beneficial to the short service employee who has an extended illness and currently receives no income after expending his or her accrued sick leave.

The provision to provide basic life insurance, at no cost to employees, is one we support. As you know, the Postal Service has provided basic life insurance to all career employees, without charge, since July 1974.

We find the transition provisions somewhat unclear with regard to participants in the current civil service system who may elect to participate in the new civil service pension system. While we have no recommendations as to entitlement, should an employee change systems, we strongly urge that all entitlements be very clearly and specifically spelled out. The decision whether to change systems will be a complicated and difficult one for most employees, and they will need complete details in order to make an intelligent decision.

We are also concerned that the bill does not make provision for some adjustments to the unfunded liability payments, which the Postal Service must make under present law, to take into account the transfer out of the civil service retirement system of employees hired since 1983 and the transfer of those others who opt in to the new system. We assume the bill contemplates that the Postal Service and other agencies would be given credit in determining their liability under the new system for the employer contributions which they have been making for employees hired since 1983 whose retirement eligibility would move from the current to the new system. Each of these matters involves substantial sums of money and needs careful study.

We are in agreement with the concept that the basic plan be actuarially sound. We do, however, have one major concern with the bill in the area of funding. The bill, as proposed, will permit OPM to make a unilateral determination, without notice, of what will become a major element of cost to the Postal Service and a principal component of postage rates. While other agencies will pay these costs from appropriations, the Postal Service must look to postage revenues for the necessary funding. The Postal Service does not have the authority to increase postage rates either unilaterally or immediately. Our ability to plan to meet our obligations and our confidence in whatever billings we receive are dependent on receiving sufficient advance notice of proposed changes and the opportunity for outside impartial review of underlying assumptions and data. These items are vital if we are to fulfill our obligations in the areas of postal rates and fiscal responsibility, as required by law.

In addition to the cost aspects of the plan, there are certain benefit issues that concern us. The lack of any survivor annuity from the basic fund for dependent children of a deceased employee is one of our concerns. While we are aware that Social Security will provide some income in this situation, we believe that some annuity, even a small one, should be provided from the fund. The annuity could be calculated on the age of the child at the parent's death and the number of years it would be paid.

Another area of concern we have is the absence of an immediate survivor annuity in those instances where the employee was not yet eligible to retire at the time of death. The effect of this lack of immediate annuity might be minimal in the case of a working spouse but is potentially devastating in the case of a nonworking spouse left with dependent children. In these cases, there would be no survivor annuity and no dependent child annuity for what could conceivably be a long period of time in the case of an employee who dies relatively young. We recommend that a survivor annuity begin on the first day of the first full month after the employee's death and that the amount be actuarially determined based on the surviving spouse's age.

The bill does not contain any requirement for mandatory retirement for law enforcement officers, as is provided under the current retirement system. The increased years of service required for an immediate annuity for a law enforcement officer will result in an older work force in the Postal Inspection Service, an occurrence we do not believe suitable for vigorous law enforcement. This 5-year extension in eligibility makes it all the more imperative that this bill contain a provision similar to the current retirement system to provide for mandatory retirement at age 55 for law enforcement officers.

In conclusion, with the exception of the concerns expressed, we believe the bill will provide a retirement system for our employees which fulfills the major ingredients we believe make for a good retirement program.

I would be happy to answer any questions you might have.

Senator STEVENS. If we require OPM to use the Board of Actuaries normal cost estimates, would that allay your fears concerning OPM's misusing costs to increase your payments to the retirement fund?

Mr. CHARTERS. We feel that that would certainly be a step in the right direction, but we prefer some third party to look at it on an independent basis.

Senator STEVENS. You mentioned the problem of the mandatory retirement for your law enforcement officers and you want that to be 55. That would mean that the eligibility for retirement and mandatory retirement in your area would be the same.

Mr. CHARTERS. Yes, sir.

Senator STEVENS. Why shouldn't you increase the mandatory retirement then to 60?

Mr. CHARTERS. I think the position most agencies that have a law enforcement component would take would be that it is in the interest of Government to have a youthful and vigorous law enforcement arm. This is not consistent with increasing and advancing age.

Senator STEVENS. Yes, but the problem is eligibility for retirement, not mandatory retirement. I had that discussion with Mrs. Horner. We can accept retirement eligibility for one who has 25 years of service.

Mr. CHARTERS. Yes.

Senator STEVENS. None of us are addressing the question of mandatory retirement.

Mr. CHARTERS. Well, we believe very strongly that we ought to retain the provision for mandatory retirement at 55.

Senator STEVENS. You don't have mandatory retirement now, do you?

Mr. CHARTERS. For law enforcement.

Senator STEVENS. At what time?

Mr. CHARTERS. Fifty-five.

Senator STEVENS. After how many years of service?

Mr. CHARTERS. Twenty years is the minimum for eligibility, but it is mandatory at 55.

Senator STEVENS. What if you don't have retirement? What if a person has 18 years at 55?

Mr. CHARTERS. I don't think that is possible, because I don't believe they go into the Inspection Service after 35.

Senator STEVENS. We will take a look at it. I think there has to be some general concept across the board as far as the Government is concerned. As I look at these various law enforcement agencies, there is no rhyme or reason in some of the provisions. Some have eligibility, some have mandatory concepts, some use 20 and 50, some use 25 years. It just seems to me there ought to be some uniform provision. In effect, it is putting into the civil service system the provisions of the military system to be able to retire at 20 years. What would you do with them under this system? They are not eligible for Social Security; they would only get one tier, they would only get the pension under that system. They still would not be eligible for Social Security.

Mr. CHARTERS. As I understand it, there is a supplemental payment that would be made. The Postal Service would have to reimburse OPM for this payment until they were eligible for Social Security.

Senator STEVENS. I think that is one of the provisions that needs some studying and we will be happy to work with you as we consider this. We hope to be able to get together the agencies that do have in fact substantial numbers of law enforcement people to see if we can get a comprehensive plan that would apply to law enforcement throughout the Government.

Thank you very much. We appreciate your being here.

Our next witness is Charles A. Bowsher, the Comptroller General of the United States, accompanied by William J. Anderson, Director of the General Government Division, and Robert Shelton, Deputy Associate Director of the General Government Division. Do we call you General now?

Mr. BOWSHER. Some people do. [Laughter.]

Senator STEVENS. Well, General, we are happy to have you here.

TESTIMONY OF CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION, AND ROBERT E. SHELTON, DEPUTY ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION

Mr. BOWSHER. Thank you very much, Mr. Chairman.

I am pleased to be here today to discuss S. 1527, a bill proposing a new retirement program for Federal employees covered by Social Security. The Social Security Amendments of 1983 required all Federal civilian employees hired after December 1983 to participate in Social Security. The Congress has set January 1, 1986, as the target date for establishing new retirement programs for these employees. This bill applies to new employees who otherwise would have been in the civil service retirement system—the retirement plan covering most Federal civilian employees. The bill also would allow employees covered by the current retirement system to transfer to the new program.

During the past 10 years, we have issued a series of reports covering a number of issues related to basic policies, financing and benefits of the civil service and other Federal retirement programs. A common thread that ran throughout many of these reports was the need for the establishment of an overall policy to guide retirement system development and improvement.

During these many years of reviewing Federal retirement matters, we have become convinced that a reasonable standard on which to base Federal retirement benefits is the prevailing private sector practice. Heretofore, this has been a difficult standard to apply because Federal employees in the civil service retirement system were not under Social Security. Private sector retirement programs are constructed to supplement Social Security. Federal retirement programs could not be constructed in the same way.

Now that new Federal employees are covered by Social Security, the Congress has the unique opportunity to take advantage of the experiences of private sector employers in designing their retirement programs to supplement Social Security benefits. Adoption of the policy that Federal retirement programs should be fairly comparable with private sector programs would assure Federal employees of equitable treatment with other employees in the Nation and would also assure the taxpayers that Federal retirement practices are reasonable. In this regard, we were pleased to note that one of the stated purposes of S. 1527 is to provide Federal employees with retirement benefits comparable with good private sector programs.

To assist your committee in designing a new retirement program, we gathered and analyzed considerable information on non-Federal retirement programs. The detailed results of our analysis are included in three of our reports entitled, "Features of Non-Federal Retirement Programs" which we issued June 26, 1984, "Benefit Levels of Non-Federal Retirement Programs" which we issued in

February 26, 1985, and "Retirement Before Age 65 Is a Growing Trend in the Private Sector" in July 1985.

We believe S. 1527 represents a comprehensive and thorough retirement program design. It combines a three-tiered approach to retirement—Social Security, a defined benefit pension plan, and a thrift plan—with free basic life insurance and a separate long-term disability plan. We found this approach to be typical among private sector employers also. Moreover, many of the specific provisions of the pension plan portion of the proposed program are completely consistent with prevailing pension plan provisions in the private sector. Other aspects of the pension plan and the thrift plan, however, are somewhat different from what the private sector programs we examined usually provided.

The cost of the proposed retirement program is estimated to be slightly higher than the average private sector retirement program. Some private sector programs cost more. However, we believe that maintenance of comparability with respect to the total compensation package is more important than is maintenance of exact comparability with respect to each element of the package. Since this bill deals with only two—retirement and life insurance—of the many elements such as pay, leave, health insurance et cetera, of total compensation and since the cost differential is small, we believe that this bill is entirely consistent with the objective of achieving comparability of the total compensation package.

We are not suggesting that, to be comparable, the Federal employee retirement program should necessarily "mirror" private sector programs. In fact, we believe the retirement program proposed by S. 1527 is a reasonable one and would serve Federal employees well. However, for your information as you consider the bill, I would like to briefly discuss the areas in which the bill does and does not reflect retirement program features typically found in the private sector.

First would be retirement age. The bill provides for unreduced pension plan benefits to be paid at age 62. Employees with 30 years of service could retire as early as age 55, but their benefits would be reduced by 2 percent for each year they are under age 62. Employees with at least 10 but fewer than 30 years of service could also retire by age 55, but would be subject to a benefit reduction of 5 percent for each year they are under age 62.

Our analysis of private sector pension plans showed that age 62 is usually the earliest age at which employees can receive unreduced pension benefits. Also, nearly all the private sector pension plans we examined provide for early retirement with reduced benefits at age 55.

Some private sector plans, like the bill proposes, apply different reduction percentages for long- and short-service employees who retire early. More typically, however, the early retirement requirement is age 55 with 10 years of service, and benefit reductions are about 4 percent a year for all retirees younger than age 62.

When considering this aspect of S. 1527, the committee should be aware of the fact that, while it differs from typical private sector practices in the amount of the reduction, the proposed early retirement provision would continue the advantageous treatment of long-service employees that now exists in the current civil service retirement system. In our opinion, this variance from private sector practices is defensible from a personnel policy standpoint because it encourages and rewards career Federal service.

The next area I would like to discuss is benefit amounts. The pension plan proposed by S. 1527 provides a benefit of 1 percent of high 5-year average annual salary for each year of service. Pension plan benefits would simply be added to Social Security benefits.

Use of a 5-year salary average for benefit computation purposes is consistent with the overwhelming majority of private sector plans. However, the proposed "add on" of plan benefits to Social Security is not the typical private sector approach.

Because Social Security benefits, as a percent of salary, decrease as income levels increase, private sector pension plans usually use some form of integration to compensate for Social Security's "tilt" to lower income employees. Between 64 and 96 percent of private sector pension plans included in the surveys we reviewed were integrated with Social Security. For example, the average benefit formula in plans surveyed by the Bureau of Labor Statistics, which was the primary source of information on private sector plans we studied, provided for each year of service 1.5 percent of the high 5-year average salary, less 1.25 percent of the employee's Social Security benefit.

The "add on" of plan benefits to Social Security causes benefit levels in the proposed plan to be generally lower for average and higher income employees and higher for lower income employees than in the typical private sector plan. The proposed plan would provide about 27 percent of final salary to employees at all income levels at age 62 and 30 years of service. In contrast, the plans in the Bureau of Labor Statistics survey averaged about 26 percent at the $20,000 salary level, 29 percent at the $30,000 salary level, 31 percent at the $40,000 salary level, and 32 percent at the $50,000 salary level.

I would now like to turn to the cost-of-living adjustments. This bill calls for annuities to be adjusted each year by the increase in the Consumer Price Index less 2 percent. Our study of private sector practices showed that the average increase each year in annuities was approximately 40 percent of the change in the CPI while large employers of more than 10,000 employees granted increases averaging close to 60 percent. The appropriateness of the bill's provision in terms of private sector comparability obviously depends on future inflation rates and, consequently, cannot be accurately gauged. CPI increases above 4 percent would give the Federal retiree at least 50 percent protection.

The proposed pension plan provides for vesting—the point in time at which a participant has earned the right to a future benefits at 5 years of service. The typical private sector plan requires 10 years of service for vesting to occur, but the trend is toward earlier vesting.

The proposed pension plan requires no employee contributions. This is consistent with the private sector approach. The studies of private sector plans we reviewed showed that very few plans require employees to contribute toward the cost of pension benefits. For example, 93 percent of the employees covered by the Bureau of

Labor Statistics survey were in plans that did not require employee contributions.

S. 1527 provides that long-term disability benefits will come from a separate insurance plan rather than the pension plan. Our work has shown that the insurance approach is most often used by private sector employers for salaried employees.

The proposed insurance plan would provide 60 percent of salary to employees who meet the Social Security Program's criteria for disability benefits, in other words, the inability to perform substantive gainful employment, less any Social Security benefits they receive. This arrangement is consistent with benefit levels in private sector insurance plans.

Employees who do not meet the Social Security disability criteria but are disabled for useful and efficient service in the positions they occupy would also receive insurance benefits under S. 1527. They would receive 60 percent of salary in the first year and 40 percent thereafter. We believe this aspect of the proposal is a good one. It will provide benefits to employees who cannot perform their jobs but are not totally disabled for other work, while reserving greater benefit amounts for those employees who cannot perform and work at all.

In general, the survivor benefit program proposed in S. 1527 closely parallels private sector practices. Social Security and free life insurance coverage would comprise the basic survivor benefit program, and the survivors of vested employees would receive additional benefits from the pension plan at the time the deceased employee would have been eligible to retire. Retiring employees could also elect survivor coverage. In all cases, actuarial reductions in benefit amounts would be required to pay for the survivor coverage as is the practice in the typical private sector plan.

We did note one inequity in the proposed program. Employees who leave Government employment after 5 years of service would retain their vested rights to survivor coverage under the bill. Benefit payments to their survivors could begin when the former employee would have reached 55. This would afford preferential treatment to some deferred annuitants over active employees. Benefits for survivors of active employees under the bill cannot begin until the employee would have been eligible to retire. A deferred annuitant or employee with fewer than 10 years of service would not be eligible to receive a pension until age 62, but the deferred annuitant's survivor could receive benefits when the deferred annuitant would have reached age 55. We suggest that this inconsistency in the bill be corrected.

The bill provides free basic life insurance for employees during their working career, but upon retirement, they will be required to pay two-thirds of the annual insurance premium until they reach age 65. The Bureau of Labor Statistics survey, as well as other studies we reviewed, showed that 80 percent or more of the employers surveyed provided free life insurance coverage both before and after retirement. The reason why the bill deviates from prevailing private sector practices is not apparent.

Since employees covered by this bill would be expected to retire on the average at age 62, which is the norm in the private sector, they would be paying the life insurance premiums for only a few years. Therefore, we suggest that the insurance coverage be provided at no cost to the employee after retirement.

The bill allows for employees to make tax-deferred contributions on a voluntary basis of up to 10 percent of their pay to a thrift savings fund. Employing agencies would match 100 percent of participant contributions up to 5 percent of pay. These contributions could eventually be invested in three funds that would be established and operated by the Government—a Government securities investment fund, a fixed income investment fund, and a common stock index investment fund.

We found that few thrift plans in the private sector provide for the employer to match 100 percent of employee contributions. The most common practice in a private sector plan was for the employer to match 50 percent of employee contributions up to 6 percent of pay.

The bill also differs from private sector thrift plans by prohibiting employees from withdrawing their funds upon separation before retirement except for transfer to an individual retirement account. We believe that this provision is sound in that it emphasizes the purpose of the plan which is to provide retirement benefits.

The thrift plan's three investment funds seem to provide an appropriate balance between the virtually risk-free Government securities and fixed-income funds on one hand and the higher risk associated with the stock index fund on the other. The initial requirement that all thrift plan funds be invested in Government securities could have a positive impact on the budget by reducing outlays for at least the next 5 years when this requirement will be phased out.

We suggest that the committee consider making investment in the Government securities fund more attractive by providing the same rate of return on these securities that the pension plan will receive on its investments in Government securities. The bill provides for the thrift plan to purchase special issue Treasury notes having 2-year maturities and receiving an interest rate equal to the average market yield of all outstanding 2-year notes as of the end of the preceding month. Other Government funds including the civil service retirement fund also invest in special issue Government securities but, by law, receive an interest rate equal to the average rate on all outstanding securities with maturities over 4 years as of the end of the preceding month. Generally, this rate should be higher than the rate on 2-year securities. The maturities of the special issue securities purchased by the other funds vary depending on the cash flow needs of the funds.

In our opinion, the provisions for funding pension benefits in the bill are sound and represent a major improvement over the funding requirements in the current civil service retirement system. The bill (first) calls for agencies to pay the full amount of accruing pension costs for their employees, (second) provides for funding of any supplemental liabilities that may arise, and (third) requires the Department of Defense to reimburse the retirement fund for the cost of military service credits granted to employees under the pension plan.

We have long held the view that Federal retirement systems should be fully funded to enhance cost recognition and budgetary discipline as well as to promote sounder fiscal and legislative decisionmaking. S. 1527 accomplishes this objective for the new pension plan. However, it does not apply the same funding requirements to the currently underfunded civil service retirement system. We would urge the committee, either as part of this bill or as a separate action, to address the funding of the current system in a similar manner. Unless this change is made, future benefits for retirees under the current system will eventually be paid from funds contributed for the new pension plan.

In summary, I should reiterate that we see S. 1527 as presenting a responsible design of a new Federal retirement program. The proposal differs from private sector programs in that the pension plan is less generous at the time of retirement than the private sector norm for average and higher-paid employees, but the thrift plan is more generous than the plans typically found in the private sector. However, depending upon the level of employee contributions to the thrift plan, overall benefits available from the program, in total, can be very competitive with programs in the private sector. We have also suggested some changes that we believe would improve the design of the new program.

Mr. Chairman, this concludes my prepared remarks. We will be pleased to answer any questions you and other members might have.

Senator STEVENS. Thank you very much. We are very happy to have you with us. Thank you for your suggestions. Many of them have great merit, and we are examining in particular the survivor benefit concepts and also the payment of life insurance premiums after retirement. In order for the initial bill to be within some cost constraint as presented to us at the time by the budget resolution, we felt that we should treat those in the way we did. I think we now have some leeway, and we certainly will make some of the changes you suggest.

Do you know what the cost of the average private sector retirement program is that you compared this program to?

Mr. BOWSHER. It is about 19.3 percent. That is based on the study the Hay-Huggins Co. did for the House Post Office and Civil Service Committee, and we think that appears to be reasonable.

Senator STEVENS. And this compares favorably with that at the present time?

Mr. BOWSHER. Yes; it does.

Senator STEVENS. The suggestions that you make would all increase the cost of the system. Do you have a figure of how much it would increase the cost of this system, for instance, to have insurance payments after retirement?

Mr. BOWSHER. We do not have that figure, but we think it would be a very minor amount. We could work on some of those estimates for you, Mr. Chairman.

Senator STEVENS. We were using the figure of 0.4 percent of payroll. You were using a percentage of payroll for the cost of the private sector systems, right?

Mr. BOWSHER. Right.

Senator STEVENS. What do you think of the option in the bill that would permit, after a transition period, the investment of these thrift funds in the private sector under employee management?

Mr. BOWSHER. I think, Mr. Chairman, it makes a good deal of sense, and I think it gives the employees the options that they can try and work with. It allows them to take a little greater risk. At the same time it gives them the option to be in Government securities and to have a very safe program. So I think it gives them flexibility. At one time people used to worry about whether this would be such a large amount as to have a great effect on the capital markets, the stock markets. From our calculations of what the amounts might be, it would not unduly influence the markets from the best we can tell. So I think it is a good option. I think the option should be there.

Senator STEVENS. You commented about the tilt of the plan, the basic pension plan, and you are correct, it is tilted primarily toward the lower income employees; but I am sure you would agree the thrift plan is tilted the other way.

Mr. BOWSHER. That is correct, Mr. Chairman.

Senator STEVENS. So if you looked at the plan as a whole with Social Security as the base and the pension plan tilted toward the lower income employee and the thrift plan tilted toward the higher income employee, it has a balance we thought. Do you disagree there is a balance overall?

Mr. BOWSHER. No; we do not disagree. In other words, the balance is there, I believe, and it is only a question of whether people at the higher end will participate in the thrift plan to the extent we and you think they would. If that happens, I think it balances out pretty well.

Senator STEVENS. It is my judgment that they will participate to a greater degree than anyone realizes if we can maintain the concept that it is deferred income. That is the real problem now after the administration's recent announcement.

Have you studied whether there are any other options for achieving the same concept we have, whether, for instance, we can use an IRA in the beginning rather than the thrift plan?

Mr. BOWSHER. We have looked at some of those and we would be willing to share whatever work we have accomplished with the committee. I believe we already have provided some of it. I think one thing that should be pointed out is that if you took the 401(k) feature out, it removes one feature that I think is very favorable to the employees, both in the private sector and also in the proposed Federal program. I would hope that that would be done only after a great deal of thought because I really think when the Government changes the ground rules so quickly after we have gotten everybody into these programs, if you come along and take that away, both in the private sector and in the Federal Government, it is a discouraging thing. But I also think the tax break is not the primary attraction for participation in your program. In other words, the key to your program is those matching funds. So I think that your program still might have a high degree of attractiveness even if the administration was to pursue and the Congress was to agree to eliminate the 401(k) feature. I think the Congress and others should give a great deal of consideration to the whole issue before rescinding that feature.

Senator STEVENS. I agree. Did the COLA figures you gave us—40 percent of CPI on the average and 60 percent for large firms in the private sector—did those include the Social Security factor?

Mr. BOWSHER. No, Mr. Chairman. These numbers came from a study by North Carolina State University of defined benefit pension plans. Social Security increases were in addition these pension plan adjustments.

Mr. ANDERSON. The net result, Mr. Chairman, was that the people actually had about 70-percent inflation protection. If you take the 40-percent protection they had on the pension plan part of the retirement package, plus the 100-percent protection on the Social Security part, then the aggregate worked out to about 70 percent.

Senator STEVENS. Were you able to compare this plan of ours with that kind of protection, taking into account that it has Social Security protection on the first tier, has a level of protection on the second tier, and is protected in the marketplace on the third tier?

Mr. ANDERSON. If inflation, by some weird and hopeful aspects, remains the way it was in the last year, let's say about 3 percent or less, the Federal retiree after your 2-percent reduction is in effect only getting 33-percent protection. On the other hand, if inflation is, say, 5 percent, the Federal retiree would get the 5 percent less 2 percent or 60-percent protection under your plan. That compares very favorably with the private sector. Now that 40 percent is a private sector average. Small firms provided as low as 20-percent protection according to that North Carolina State study. Larger firms with as much as 60 percent. The bottom line is we feel the plan provides, under a reasonable scenario, something comparable to what the private sector is getting. Something fair.

Senator STEVENS. The third tier has a higher level of protection.

Mr. ANDERSON. Yes, sir; absolutely. The thrift plan tier, you mean.

Senator STEVENS. So wouldn't the average be higher than that?

Mr. ANDERSON. I am sorry, I have not worked in the thrift plan part of it. You are absolutely correct. We have 100 percent on Social Security; at 5-percent inflation, 60 percent on the pension plan; plus as much as 100 percent on the thrift plan.

Senator STEVENS. That is the way I look at it. I hope we are right.

General and gentlemen, GAO has contributed very heavily to the work that has gone into the studies that led to this plan. We have relied upon your agency and on the Congressional Research Service and on some private sector services, too. Your studies have been timely and most helpful. I want to thank you for the work you have done so far. As we proceed here, we are going to be bouncing off of you suggestions we are and will be getting on some changes. I don't know if you have had a chance to look at the OPM suggestions concerning the deferral of the impact of the military credit. You weren't here when I mentioned that, General.

Mr. BOWSHER. We would much prefer what you have in the bill here. We haven't had a chance to look at it very carefully but our initial reaction is we would not agree with their concern here.

Senator **Stevens**. I would appreciate your giving their suggestions consideration in terms of the financial impact on the plan. I note your comment about the civil service retirement system, and incorporating into it some of the changes we are making here. We want to do that but we want to get this plan through first. Then, hopefully, once we have this one through, we can go back and incorporate into the civil service retirement system, with little controversy, the changes which we have agreed to with the House and which the President has agreed to.

Mr. **Bowsher**. That might be a better approach.

Senator **Stevens**. I think we would be sort of opening up two Pandora's boxes at once if we start tinkering with the other plan. The other plan ought not to be tinkered with in any way that would reduce benefits because we made a commitment that the existing plan will not be adversely affected by the creation of a new plan. I would hope you understand why we did not follow your suggestion there.

Mr. **Bowsher**. Yes, we do.

Senator **Stevens**. Senator Gore.

OPENING STATEMENT OF SENATOR GORE

Senator **Gore**. Thank you, Mr. Chairman.

I am sorry that my plane was late in taking off in Atlanta this morning; otherwise I would have been here for the first witness, as well as for this panel.

Senator **Stevens**. Do you have an opening statement you want to make, Senator?

Senator **Gore**. I do have a prepared statement but I note the witness list is a very long one. Rather than taking up everyone's time, I will just put it in the record and go straight to questions. It will be substantially similar to the statement I made on the occasion of your introducing the bill which brings us here today.

[Prepared statement of Senator Gore follows:]

Prepared Statement of Senator Gore

Thank you, Mr. Chairman.

As I stated at the time of S. 1527's introduction, we face a complex and critical task in our efforts to redesign the Civil Service Retirement System for Federal employees covered by Social Security. The Social Security Amendments of 1983 left Congress with a difficult responsibility in fashioning such a system. It is a duty that we must and should discharge by the end of this year.

Congress' responsibility to develop a new retirement system is important. If we fail to act, tens of thousands of Federal employees who have started work since January 1984, or who will be coming to the Federal Government in the future, can expect to contribute up to 14 percent of their hard-earned pay, for pension benefits which will be uncertain at best. Moreover, in designing a new retirement system, the Congress is in a unique position to influence the kind of Federal work force this country should have.

The focus of our deliberations must be to ensure that Federal employees, at work and upon retirement, receive fair and reasonable compensation for their service. That compensation should be fair and reasonable in the eyes of the workers themselves, whose efforts are vital to the varied functions of our Federal Government. It should be fair and reasonable, as well, in the eyes of the taxpayers who correctly insist that their tax dollars be spent sensibly and to good result.

S. 1527 is a significant step in the right direction. The careful attention to details both of substance and of leadership which Senators Stevens and Roth have devoted to this challenge over the past several years has been evident in every aspect of the process. That wisdom and leadership has left a positive imprint on the legislation which brings us here today.

On my side of the aisle, the senior Senator from Missouri has done much to foster a spirit of cooperation and bipartisanship in our consideration of this issue. Prior to the introduction of the bill, potential differences were fully aired, without the rancor that often characterizes issues in which the stakes are so very high. Consequently, our task is to strike a proper balance within a narrow range of disagreement.

As in many of these deliberations, we must take a close look at many highly technical issues. A web of formulas, categories, and requirements must be woven into a coherent and sensible policy-a policy that is clear enough for those who will depend upon it for their economic security, and flexible enough to address the various situations and needs that Federal workers may face during their careers.

Several areas in the Stevens-Roth bill warrant careful scrutiny. How we decide these issues will shape the basic structure of the plan and its pattern of payments for decades to come. Each area of concern requires important choices; taken together, those decisions will form the heart of a sound and adequate system.

First we must decide how much we should protect future pension benefits from dwindling in the face of rising prices. To be sure, this is a familiar and difficult issue for all of us. The fixed incomes of retirees must be accorded a measure of economic security.

Because Social Security continues to be fully and automatically adjusted for changes in the cost of living, it serves as the basic component of income protection for all workers. But a pension must also serve as a dependable source of retirement income, which is possible only if its value is maintained. The Stevens-Roth bill depends primarily upon the inflation protection granted by the Social Security cost-of-living adjustment. While the expense of COLA's in benefit programs is of great concern to all of us, we must be careful not to schedule an erosion in benefit value that grows worse with each passing year.

As they plan for their retirement years, Federal employees deserve to know with certainty at what age benefits begin. The current Civil Service Retirement System has been criticized for permitting employees to retire as early as age 55. This costly feature of the system will undoubtedly be a major focus of any new plan.

It is important to note that many private sector employers, particularly those with a heavy concentration of physical labor, permit unreduced retirement at age 55 to workers with careers sparming 30 or more years. Virtualy all private sector pensions make some provision for retirement at that age. Furthermore, despite the range of jobs in the Federal Government and the private sector, the average retirement age is around 61-for workers inside or outside the Government.

With 62 as its earliest age of eligibility, Social Security reduces the benefits Federal employees would receive at earlier ages. The Stevens-Roth bill goes further, by reducing the Federal pension benefit drawn before age 62. We must consider carefully the impact this provision would have on Federal workers, particularly those who work long careers in difficult and demanding occupations.

We cannot possibly guarantee every worker in every circumstance the same total benefits he or she would now receive. But we can put together a package of benefits from Social Security, from a supplemental Federal pension, and perhaps from an employee savings plan, that is generally comparable to the existing system.

The issue thus becomes one of determining the appropriate mix of benefits to achieve this goal. An employee saving plan with government matching funds will give every worker the opportunity to supplement a defined and predictable pension amount. But many workers will not be in a financial position to participate in the savings plan fully and consistently throughout their careers. As we move toward a final mix of benefit components, we must be sure that the basic defined pension, along with Social Security, produces adequate retirement income on its own. Contributory savings plans should serve as a supplement available at the choice of the employee.

During the Governmental Affairs Committee's deliberations, every aspect of this lengthy bill will have to undergo rigorous examination. A pension plan must not only meet the obvious and expected needs of its retirees, but must assure its participants and their families adequate income protection in the event of death or disability. We can do no less than provide our employees a package of specific family protections should such family disasters strike.

The Stevens-Roth bill addresses these concerns with care. With that beginning, I am confident that Federal workers and their families can expect a final bill that combines compassion with confidence and good fiscal sense.

The testimony which the committee will receive this week comes from a diverse collection of interest—interest with important stakes in the outcome of our deliberations and interests which can all expected to make a contribution to that outcome.

Senator GORE. Let me just ask a few questions here so we can move this hearing along.

General Bowsher, in your statement you noted that the average private sector COLA is about 40 percent of CPI and then you quickly noted that the companies which have more than 10,000 employees tend to provide COLA's at an average of 60 percent of CPI. I am curious that you were not similarly quick to point out, in discussing system costs, that while the average is around 19 percent of payroll, the average for the larger companies with work forces more comparable in size to the one we are discussing here is considerably larger; isn't it?

Mr. BOWSHER. It is about 25.1 percent, Senator

Senator GORE. 25.1 percent?

Mr. BOWSHER. Yes.

Senator GORE. I didn't want that omission to go unnoticed because I think it is a significant figure.

Second, GAO has consistently recognized—before I go to the second point, the payroll cost of this proposal would then be quite a bit lower than the payroll cost of the typical private sector plan among those employers with larger work forces, correct?

Mr. BOWSHER. Yes, and it is also the case generally with the larger corporations and the ones that are doing well—in other words, one of the things in the private sector you have to keep in mind is some of those larger companies all of a sudden hit a a period of not doing well--sometimes cannot do as well for their retired people.

Senator GORE. It would be hard to assert that the Federal Government should be equated with those that are doing well. [Laughter.]

That is another point.

Second point. Isn't it true that GAO has consistently recognized in recent years that Federal benefits on a total compensation scale have lagged behind those in the private sector? In other words, when you add together salary, health benefits and pension benefits and look at the total compensation package the way any normal person looks at a package when making a decision on where to go to work, that the Federal package has lagged behind, correct?

Mr. BOWSHER. Correct, Senator and it is one of the reasons I had so much trouble with some of the Grace Commission recommendations on the pension plan where they thought you could just change the retirement age very quickly up to age 65. They were not looking at total compensation. I think the Government has to look at total compensation if you are going to attract the kind of people we need to run Government.

Senator GORE. Traditionally, of the three components of that package I mentioned, the retirement component has been the most attractive relative to its counterparts in the private sector, correct?

Mr. BOWSHER. Correct.

Senator GORE. So if you have a total package for Government employees that is lower than in the private sector and you take the one part of that package which has in the past been the only one that is relatively attractive and lower it to a level below the average figure for the larger private firms, then the effect will be to reduce significantly, or to reduce the overall compensation package so that it lags even farther behind—would you agree with that?

Mr. BOWSHER. It would be hard to argue against the logic of that but I think you get some features in this new plan that are really quite attractive. In other words, I think affordability will be much enhanced for people in Government. We have been watching this very carefully at GAO and we do believe that this is an attractive retirement package for future Government workers. This component of the compensation package, the retirement program, in other words, would be quite competitive. I still believe that the pay, salaries, is the basic problem in attracting qualified people into Government, especially at senior levels. Pay is certainly behind what I think is competitive.

Senator GORE. Please don't misunderstand the architecture of the question as will be apparent from a reading of my prepared statement. I commend the chairman and the chairman of the full committee for moving this bill forward and our disagreements are within a relatively narrow range, but I do want to underscore the effect on the total Federal work force of simply equating the payroll cost of the Federal retirement plan with the payroll cost of the average payroll plan in the private sector, of both small and large firms, because if you look at that component as a part of the overall compensation package, which is already behind those counterparts in the private sector, then the net effect could be to reduce the attractiveness of Federal employment still further.

What would GAO's reaction be to a thrift plan contribution level that is weighted toward the lower end of the income or contribution scale, such that the first 1 or 2 percent of salary contributed to the plan would be matched dollar for dollar while the remaining portion would be only partially matched?

Mr. BOWSHER. We would have to look at the figures on that. It would tend to make it more attractive for the lower-paid people. One of the question marks here and I think probably what you are getting at, Senator, is can the lower paid people come up with the money to go into the thrift plan and let's put some incentives for them in there.

I think one thing, to go back, to the overall compensation question, if there is one thing that tends to be out of whack, you might say, it is the compensation for the more senior people in Government holding the more responsible positions. One of the things this retirement program ought to do is to have some kind of balancing, in the thrift plan, you might say, for the people holding the more senior positions because that is where, I think, the compensation, the salary part gets more out of whack with what is in the private sector. I think at the lower levels the Government pays pretty competitively. We would be willing to look, though, at any alternatives that you want us to look at.

Senator GORE. I appreciate that offer and I will take you up on it. Do you agree that it is very difficult to predict or model the distributional pattern that would result from these various combinations?

Mr. BOWSHER. Yes, Senator, we do.

Senator Gore. So it could have a distributional impact more tilted to one end of the salary scale or the other compared to what we can now predict. But one question I have in that regard is whether or not you believe lower salaried employees will be able to participate. It's a subjective judgment, given the weakness of all of the models in this area, but do you think that lower salaried employees would be able to afford to participate in the thrift plan to the extent necessary to provide an adequate retirement income?

Mr. Bowsher. I think that is probably one of the biggest question marks about the program and one where I hope the answer is yes, but we're not as confident about the answer as some of the others that we can give. Bill, if you would like to add something.

Mr. Anderson. I would like to comment on two things, sir. First, if the employees did no more than take that 1.3 percent that they would no longer be paying into the existing retirement plan and put it into the thrift plan, that 1.3 percent over the course of a 30-year career could provide them with around 12 percent of final pay as part of the retirement package.

Studies have been conducted of thrift plan participation out in the private sector and it does vary, depending upon the amount of the employer contribution. However, with a 100-percent match, the studies we saw, discussed in one of the reports we put out, indicated that participation ran up around 80 percent, and I would just assume when you are talking 80 percent, you are down into the lower-paid employees within the organizations that were studied.

Senator Gore. You could use that as an argument in favor of the extra incentive for the first 1 or 2 percent, couldn't you?

Mr. Anderson. Yes, sir.

Senator Gore. I will be talking with GAO further about that proposal. Just three more questions. What is GAO's reaction to a so-called back-loaded accrual rate whereby the multiplier used to determine retirement benefits, rather than being a single percentage, is a gradually increasing amount which increases according to seniority?

Mr. Shelton. That certainly is the way the civil service system is constructed currently. There is plenty of precedent for it in the Federal pension plan.

Senator Gore. What is your reaction to it?

Mr. Shelton. Probably our reaction would be that the actual formula, how you get to that end result, is not as important as the end result itself. What is more important is what is the replacement rate, the amount of benefit compared to salary at the time of retirement.

Mr. Anderson. Let me say, Senator, the standard really ought to be what is that overall level of retirement benefit that we believe the Federal worker is entitled to.

Senator Gore. If you want to elaborate on that for the record, feel free to do so. You note in your testimony that the prevailing practice in the private sector regarding vesting of retirement benefits is a 10-year rule. Is GAO advocating changing the bill accordingly?

Mr. Bowsher. No; in other words, we think the 5-year rule is the right rule. As you notice also in our testimony, we say the trend is toward——

Senator GORE [interposing]. The trend is toward 5——

Mr. BOWSHER [interposing]. That is correct, especially taking into account the role of women in the work force today, more and more companies are considering moving it from 10 down toward 5.

Senator GORE. This is something we can't avoid, but I am interested in your response to this: What problems or inequities might we anticipate as the consequence of having two such different programs operating within the Federal work force simultaneously?

Mr. BOWSHER. I think it is going to be very interesting to see how many of the existing employees convert into the new system, and it is very hard to predict. If the new system is viewed as being attractive by a large number of present employees up to a certain age, let's say—because I think most people believe that what you will see is kind of a break point at some age, they are not quite sure what it will be—they may think it better to take the new system rather than the old because it gives them more flexibility and, as I say, more affordability. It is just hard to predict but it could happen that most people might be under this new plan, say, within 10 years.

Senator GORE. Just one more question. Periodically, administrations have found it necessary to undergo major RIF's or reductions in force. One component of RIF policy which attempts to make it somewhat more humane is to provide for early retirement for workers with over 25 years of service, and for those over age 50 with 20 years of service. That sort of component appears to be a reasonable inducement to retire early, provided that the early retirement benefits are sufficient.

Would you favor an early retirement component as an inducement and, if so, how would you seek to insure that those early retirement benefits are made sufficiently attractive to provide such an inducement?

Mr. BOWSHER. Are you saying the early retirement you described is something in the private sector now or was in the old plan?

Senator GORE. The old plan.

Mr. BOWSHER. I think the two criticisms that the existing plan has been subjected to by the people in the private sector, it seems to me, are the unlimited COLA protection in place during the 1970's during that high inflation period where most people in the rest of the economy were not given 100-percent protection, and the age 55 retirement. A lot of people in the private sector do not understand why people in the Government sector should be able to retire and all too often in their view go out and get another job in the private sector. So I think this plan that brings the retirement age up closer to what it is in the private sector makes a lot of sense as far as getting the Federal workers away from the criticism that has been brought down upon the retirement plan, which I think primarily came down in the 1970's when you had the senior people frozen as far as pay level and you had COLA adjustments for the retired people so you ended up with the anomaly of retired people making more than persons working in Government.

The problem is as much as anything the pay cap, not the retirement plan. I do believe if you had some kind of early out, at times it is one of the best ways to achieve a reduction in force. I agree with you there. Maybe it is something that ought to be considered.

I think the proposed plan here, moving the average age up to 62, has a lot of features to gain public support in this country for the Federal workers.

Senator GORE. Thank you very much. Thank you, Mr. Chairman.

Senator STEVENS. Senator Glenn.

OPENING STATEMENT OF SENATOR GLENN

Senator GLENN. Thank you, Mr. Chairman.

The objective of any changes for any system like this has to be to get good people in. No. 2, how are we going to keep them in, and three, are we going to be able to do this through their employment lifetime, and do it fairly without being excessive. Those are the balances that we are trying to deal with here. We are dealing with hundreds and hundreds of billions of dollars here and so the competition to get good people is very intense. With all these changes here and whether we are going to be able to recruit good people with this new system, have you been able to run any studies or do you have any studies to indicate whether this is going to be attractive enough so that we can really be competitive? I know it is a general question. It has to be asked because that is the objective of the new system. We wouldn't be dealing with a bill at all if it wasn't trying to make sure we get good people into Government.

I think the bottom line has to be studies of some kind whether this is going to be sufficiently attractive.

Mr. BOWSHER. We have not done a study as explicit as what you are asking us about, Senator, in regard to this new plan, where you can go out and show it to a number of people and ask whether they would find it attractive to come into the Government now. We did some studies in the private sector along those areas and we found those plans were attracting qualified people.

Again, though, to get back to one thing Senator Gore pointed out, is it the overall total compensation or total package that most people will look at when they make a decision to come in, and I think as long as you have the Government people being paid less than a comparable rate, it will be difficult to attract qualified people even though you have a pretty good retirement program.

We have not done the studies that you are asking us about.

Mr. ANDERSON. The point was made earlier by Senator Gore—in fact, we are going to be cutting the size of the total Federal compensation package if in fact the bill were enacted essentially as written. Instead of that 24.7 percent of payroll we currently give to employees, or the equivalent, we would be giving them something over 20 percent. We make the point still that the private sector seems to be an appropriate standard to be used for all aspects of the Federal compensation package. But the Congress has to concern itself also with rectifying that shortfall Hay Huggins pointed out in the amount of the total compensation package whereby the Federal worker still lags behind the private sector across the board by 7 percent before this latest setback.

Senator GLENN. The Federal Government is a very large institution, of course. Have you compared the Federal Government employment with only the largest companies, say IBM, AT&T, GM, Ford, employers like that?

Mr. ANDERSON. Some of the studies we have looked at, sir, restricted themselves to the very largest firms in the Nation and there is a real difference in the level of benefits afforded by that type of employer as contrasted with employers generally. The value of a retirement package might average 10 to 13 percent according to some of the studies for smaller employers. When you get up into the larger ones, you are talking 25 percent of payroll so there is an order of magnitude over two times as great out there in the private sector. The larger firms, the IBM's, the top 10 percent have a package that is even better than that much-maligned package the Federal worker gets today.

Senator GLENN. Should we be comparing our plan with the larger firms or should we be comparing our plan with national averages? I think when people sign on with the Federal Government, the size of this institution we are running here as the Federal Government, we should be competitive with those other very large institutions if we expect to recruit and retain qualified personnel. Those companies are the ones dealing in the technologies and all of the things we have to deal with at the Federal level.

Mr. BOWSHER. I think you are right, Senator, and I think we should be comparable to the better employees. I don't think we can be comparable probably to the very finest programs out there in the private' sector. I think there are certain corporations, as Bill points out, that have outstanding programs for their employees and I am just not sure the Federal Government could afford to have that. I think you are right. I think when you are talking about, as I often say, the program in the Navy in the nuclear power area, the space program, some of the law enforcement areas, the IRS where we are trying to have people that can go toe to toe with the best accountants and lawyers in the private sector, you have to attract qualified people if you are going to have the Government operate well. There is just no question about it. I think our program should be compared to the larger and the better run companies.

Senator GLENN. That is who we are going to be in competition with. That's right. Regarding specifically the thrift plan provision, do we have any studies that will show who will probably take advantage of it? The middle and higher income workers use the IRA's. Do you believe 100-percent Government match encourages lower salary workers to participate also? Is that the main factor on that?

Mr. BOWSHER. Yes, that is the main factor. We think that will be the main reason why the lower income people may participate. As Bill pointed out, if they put in the amount they are currently contributing to the civil service system, they will have a very substantial amount when retirement age comes. I will say without question that one of the bigger question marks of the proposal is how much participation will you get in the thrift plan. There is no question that in the private sector, when we look at different plans in different companies, the higher income people tend to partake more than the lower income, just because they have more disposable income.

Senator GLENN. I think that is going to be a problem if they are going to have a substantial chunk of their income now taken away.

It is easy to say I need this now, maybe I can do this later and put it off and then you don't have participation.

At the latter end of their careers participation would probably pick up. You said the proposal differs from private sector programs in that the pension plan is less generous at the time of retirement than the private sector norm for average and higher paid employees. You say the thrift plan is more generous in the private sector.

I am concerned that we get up here, half-way through a career, and we have very promising managers which we need, many in our Government these days; and the attractions are on the outside and we see that repeatedly. I don't really see that we are correcting that with this legislation. I frankly don't know how you correct it. That is of great concern to me—not only to attract good people but then when we do get people, just as they are about to move into very competitive management positions, we have the old revolving door bit all across the Government, not just in the military, and we lose people to industry who should be the top level of Government managers. How do we keep those people? Are we going to be able to do it with this? I don't see it is going to correct that problem.

Mr. Bowsher. I think, again, it is the cast of the total compensation package and I agree with your concern, Senator, I don't think at this point in time there is a total compensation package for the rising middle manager and then on into the senior management positions in the Federal Governement that is as attractive as the private sector can hold out, and we are having a very hard time, I think, holding onto our best people. I think the thrift plan is, again, one of the stronger features of the proposal. I think the attitude is also a factor. Right now a lot of Government people do not feel well appreciated and I think that contribute greatly to the fact that many of them are willing to leave.

I think if you have a total compensation plan that allows your more successful people and the people you are really relying upon to live well, to educate their children, to take a decent vacation once a year, a lot of people will stay in Government because of the attractiveness of the work and the issues that they work on. When they come up and face the college education expenses and they have a compensation plan that does not allow them to send their children to the best universities and colleges, they start to think about the private sector. It's a real problem. So I share your concern.

Senator Glenn. Just one other question. Women have some special problems in pension retirement income areas. Through some of the hearings on the Special Committee on Aging, we faced up to some of those and had testimony about gaps in pension protection due to breaks in services and changes in jobs. In the current Civil Service Program many women leave the Federal work force with no coverage for retirement at all. Will the new system help this situation, portable social——

Mr. Bowsher [interposing]. Yes; it will, since they are under Social Security and, therefore, can add that to any other Social Security they have. I think the whole portability of this plan is quite a bit better than the previous plan.

Senator Glenn. Thank you, Mr. Chairman.

Senator STEVENS. Thank you, Senator. I am pleased to have your comments. I would hope the review of this proposal would lead Congress to understand that the basic problem in attracting and retaining the better people for employment in our Government is the compensation system itself. We have not addressed the inequities of the compensation system. I also believe the suggestions to decrease the match on the thrift plan would be counterproductive as far as retaining the higher-paid employees. Certainly if you look at this for someone who has a $60,000 income who can have what amounts to a $3,000-increase in compensation by virtue of initiating a plan of deferring income tax on $3,000—in other words, have a deferred taxation on $6,000 of income, put together with the provision for a loan to be made against that amount to help send children to school and what not, it seems to me that we have—I hope Senator Glenn will notice—we have tried to build into this plan facets that would enable us to keep those higher-paid people with some very attractive provisions. I hope everyone will study them.

Mr. BOWSHER. Mr. Chairman, we would strongly support those features.

Senator STEVENS. You did examine the loan provisions. Are those comparable in the private sector. Do they have loans against their thrift plan?

Mr. BOWSHER. Yes.

Senator STEVENS. I, particularly, think they are very good and wish we had had that provision when I had five children in college at the same time, I'll tell you. We do thank you very much and will be calling on you further for your help as we go along.

Mr. BOWSHER. Thank you very much, Mr. Chairman.

Senator STEVENS. Our next witness is Donald Ledbetter, president of the National Association of Postal Supervisors, accompanied by Andrew Ruddock, who is his consultant.

Mr. Ledbetter.

TESTIMONY OF DONALD N. LEDBETTER, PRESIDENT, NATIONAL ASSOCIATION OF POSTAL SUPERVISORS, ACCOMPANIED BY ANDREW E. RUDDOCK, CONSULTANT

Mr. LEDBETTER. Mr. Chairman, members of the committee, my name is Donald Ledbetter. I am president of the National Association of Postal Supervisors, an organization representing some 44,000 midlevel managers in the U.S. Postal Service. With me today is Andrew Ruddock, an expert retirement consultant to our organization.

In the interest of time, I will summarize my remarks, but request that a copy of my full statement be printed in the record.

We are pleased to be here today to offer our views on S. 1527, a bill to establish a new retirement system for postal and Federal employees hired after December 31, 1983.

Mr. Chairman, we would like to congratulate you for the diligence, hard work and leadership in this area. You and Senator Roth, chairman of the full committee, and Senator Eagleton did an excellent job in insuring that all interested parties had an opportunity to express their views. The public policy forums in particular held in late 1983 and 1984 gave a good, solid background on which to begin this debate.

We agree the time to move ahead on development of a supplemental plan is now. Because of the wealth of information that is available, we think it is possible to develop a plan this year that meets the needs of employees, the employer and, in our case, the taxpayer as well.

In my testimony today, I would like to review some of the provisions of S. 1527 we support, some that we do not and some specific recommendations for changes. Despite our continued opposition to Social Security coverage for any postal or Federal employee, we recognize the reality of the situation and for that reason, do support the three-tiered approach contained in your legislation.

The combining of Social Security with a defined benefit supplement and a thrift plan is the best possible combination of prevailing practices in both the public and the private sectors.

We strongly support the use of the present civil service retirement fund for the financing of both the old and new systems. As you will recall, one of our major concerns in the social security debate was the drain on the civil service retirement fund if new entrants were totally cut off.

In general, we are also supportive of the disability provisions. The inclusion of Social Security disability benefits provides a higher replacement of predisability earnings if the employee meets the Social Security definition of disability. If the employee is regarded as disabled only for his or her job in Government, the disability benefits remain about the same as now provided by the current system. We do not, however, see the advantage in having a third party administer the disability program outside Government. Obviously, the required coordination with Social Security would add to the present administrative costs, but we think handling claims in-house would be less costly than contracting out that function, and thereby paying profits to a private insurance company.

As I mentioned, we do have problems with some of the present provisions of S. 1527. First and foremost, we are concerned with the overall level of benefits. From our perspective, there is no reason to adopt a plan that costs 17 percent less as a percentage of payroll than the present civil service retirement system. In light of the findings by the Hay Associates, as reported to the House Post Office and Civil Service Committee, there is no justification for the Federal Government to provide such a low-cost plan. As Hay noted, total Federal pay and benefits are already 7.2 percent less than those in private industry. Hay further found the present employer cost of civil service retirement benefits is less than the payroll cost of 25.1 percent or more for the top 10 percent of large employers in private industry.

The average retirement cost for the private sector we hear most often is 18.5 percent of payroll. However, that percentage takes in the mediocre and those private companies that have little or no retirement benefits for their employees.

We believe the Federal Government should be a leader because of its size and the nature and importance of its work. In order for the Federal Government to effectively compete for quality employees, the Government must provide a benefits package similar to that offered by the top companies in private industry, not the average or mediocre.

Second, although we support the concept of a thrift plan, we do not think Government's contribution should match 100 percent up to the first 5 percent of employee contributions. The prevailing practice in the private sector is to match 50 percent up to 6 percent of employee contributions. The costs for higher Government contributions in S. 1527 could be better used to improve the defined benefit portion of the plan.

The thrift plan should be used to encourage employees to save and thereby provide extras during retirement, not as a primary source of retirement income.

Our recommendation is for Government to match 50 percent of employee contributions to the thrift plan up to 6 percent. The tax-deferred component would encourage people to save at either the 100-percent match or our preferred 50-percent match. This assumes, of course, the President's proposal to eliminate the tax-deferred status of so-called 401(k) plans is not adopted in any tax reform measure. Removing the tax incentive from the thrift plan would make it considerably less attractive.

There are several changes we would like to recommend that would, in our opinion, improve S. 1527 for the Government as an employer and also for the employee.

First, we strongly recommend an elimination of the 2 percent per year penalty for optional retirement before age 62. The prevailing wisdom behind the adoption of the present unreduced benefit at age 55 with 30 years service still applies. It was adopted in part to keep the work force young and vigorous and to increase the opportunity for younger workers to move up the promotional ladder. It improves employee morale and productivity and has served both employees and the employer well.

It was reported as recently as September 4, 1985, in the Washington Post that CBS, Inc., is encouraging 2,000 of its employees who are at least age 55 and have 10 or more years of service to retire by November 29 of this year. To make early retirement more attractive, the benefits of employees who accept the offer will be computed as if they were 5 years older and had completed an additional 5 years of service.

Providing for an unreduced annuity at age 55 with 30 years service would cost in terms of percentage of payroll only .5 percent which is relatively small in relation to the benefits we believe it supplies.

Second, we believe there should be full cost-of-living protection. As presently drafted, S. 1527 would provide annual COLA's equal to the change in the CPI minus 2 percent. Assuming inflation was at 4 percent a year, under this provision, the retiree would lose 15 percent of his or her purchasing power over 7 years. In 21 years, over half would be lost. The primary purpose of a retirement plan is to maintain a retired employee and his or her dependents in a standard of living that is reasonably consistent with the income they enjoyed during the preretirement years.

While a thrift plan may help, it does not alleviate the need for COLA protection. We recognize providing full COLAs is costly and would add 3 percent of payroll to the cost of S. 1527, but we believe it is necessary to protect retirees on fixed incomes from the damaging effects of inflation.

Three, we recommend there be an improvement in the accrual rate contained in S. 1527. For a number of years, the present civil service retirement system has assured adequate retirement income after a full career of 30 to 35 years. S. 1527 would not do that for the new employees using the 1 percent accrual rate for each year of service.

Social Security benefits plus the defined benefit supplement would be lower than current civil service annuities at all but the very lowest pay levels. A typical accrual rate in private industry is 1.5 percent. If for cost reasons a 1.5-percent accrual rate is too high, the Congressional Research Service estimates that the accrual rate of S. 1527 could be increased to 1.2 percent for a cost of 2.3 percent of pay. To encourage career or long-term employment, a slightly more costly alternative would be 1 percent for the first 10 years of service and 1.5 percent for years after 10.

Four, we recommend a retention of the high-3 average salary to determine annuities. Basing annuities on high-3 average salary as opposed to high-5 more closely reflects the economic conditions at the time of retirement.

A high-5 average will reduce annuities by about 7 percent, yet retaining the high-3 average would only increase the cost of a supplemental plan by about .9 percent of pay. Again, this is a relatively minor cost considering the financial hardship the high-5 average would cause postal and Federal employees.

Five, we strongly recommend the survivor benefit provisions of S. 1527 be improved. The inadequacy of this provision leaves many survivors nearly destitute as clearly shown in our exhibit 1.[1] Under our example, a survivor benefit could be $73 a month and would not begin until 10 years after the death of an employee when he or she would have been eligible for retirement.

We recognize under S. 1527 the survivor would receive a benefit from the thrift plan if the employee participated and would qualify for a Social Security survivor benefit at age 60. However, under the present system, in addition to the survivor annuity of $550 a month, that same survivor would have income from any savings that the employee laid aside.

Last, the survivor would receive under S. 1527 a life insurance payment of $32,000, which is 1 year's salary plus $2,000, but this is no different than what the survivor would receive under the present system unless the employee was one of the few who elected to waive life insurance.

Obviously, we have given a worst-case example, but it does clearly show that the survivor benefit provisions of S. 1527 are far below those of the current civil service retirement system. We urge that S. 1527 be revised to give a surviving spouse an immediate benefit equal to 50 percent of the unreduced earned annuity.

We also recommend an elimination of the increase in the Government's contribution to FEGLI—the Federal Employees Government Life Insurance Program. The costs for employees is relatively minor and easily affordable and the Government's contribution could be better used to improve defined benefits.

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[1] Exhibits referred to appear in Mr. Ledbetter's prepared statement.

Finally, we recommend employees contribute 1.3 percent to the defined benefit supplement. This would make contributions of old and new employees nearly equal and would reduce Government's cost by 1.1 percent of pay. The 1.1 percent amount is less due to refunds given to employees who leave before retirement age. We recognize it would be impractical for employees in both the old and new systems to contribute exactly the same amount due to the nature of Social Security contributions. But we do believe the contributions, like benefits, should be as nearly equal as possible.

With all the changes we have suggested, the 20.8 percent Government cost of S. 1527 would be increased to 24.9 percent of pay. In exhibit 2, we detail those changes and the cost associated with each of them. The estimated costs for all the various items were supplied to this committee by the Congressional Research Service of the Library of Congress.

The final cost we reached is relatively equal to the cost of the present civil service retirement system and is consistent with our policy of providing comparability and equity between old and new postal and Federal employees. It is still less than the 25.1-percent payroll cost for the top 10 percent of large employers in the private industry.

We have additional recommendations which I will not at this time enumerate, but they are included in our full statement. In addition, there are a number of technical problems we see in S. 1527 but they are relatively minor, and we would be happy to get together with your staff to discuss them at a later date.

Mr. Chairman, we appreciate the opportunity to offer our views on S. 1527 and want to reiterate our strong commitment to seeing a bill pass this year that is not only in the best interest of the people we represent, but the Government as an employer and the American taxpayer. We will be happy to respond to any questions.

Senator STEVENS. We want to thank you very much, Mr. Ledbetter, for your very thorough comments. There are many we all disagree with. The problem is we must find a balance in terms of the budgetary restraints that are imposed upon us. We hope to make some changes as we go ahead now. The comment about insurance, for instance, that was in our original plan. We didn't have free insurance. We had it in the defined contribution plan, which is a better plan, but there are people who wanted the insurance coverage, so we negotiated out several of these provisions.

I think we all have to keep in mind also that we hope to go to conference with the House and arrive at a bill to send to the President before December. Since the House has some particular points they want to make, we more or less left them out knowing that they are going to add them in.

I hope that everyone is aware of the process that we go through in order to get a workable relationship with our colleagues in the House. I know specifically some of the things they are very interested in, and we are sort of light in those areas so they can make their contribution. Maybe that is being too direct in terms of how we are dealing with this proposal, but that is the way it is.

Mr. LEDBETTER. We realize that, Mr. Chairman.

Senator STEVENS. We are going to work with you very closely. I think your comments are very good ones. We put a little more stress on the thrift plan and its value as part of the pension system. I, for one, believe that the estimates saying there will be a low participation in the thrift plan really are not realistic. I cannot think of anyone who would not be willing to put away a dollar in order to have an increased dollar of compensation, particularly if both dollars are not taxed during this current year.

Mr. LEDBETTER. There has been a lot of emphasis on whether the higher paid employees would participate. I think the difference is in the age of the employee because the younger employee, regardless of whether that person is in a lower paying job or higher paying job, has a lot more family responsibilities than a person with a few years down the road has.

As you mentioned with your five children in college, once those kids are out of college, I think whether you are a letter carrier or supervisor, you will be more likely to participate in a thrift plan than you would when you still have kids in school.

Senator STEVENS. You are right. We are looking at some of those things. We are looking at whether or not there should be some greater emphasis on the thrift plan in the later years of employment and some higher rate of contribution from the employer, as you suggested, in order to retain those people who have some longevity. All the suggestions you make, I think, have great merit, and we are thinking about the same things, if we can do so and stay within the financial constraints of the budget and the way we view those limitations with regard to this proposal.

I do thank you very much. I do not have any questions. I think I understand your position and do not find myself too much in disagreement with it if we didn't have the financial limitations that we face. That is the real problem. Every one of those suggestions that you make, even though the increase is very small, continues to increase the percentage of payroll contribution. We are looking at all of these and will continue to work with you.

Mr. LEDBETTER. Thank you.

Senator STEVENS. Senator Gore.

Senator GORE. Thank you, Mr. Chairman. I just want to underscore the chairman's comments about anticipating the conference that will be upcoming on the bill. I feel very strongly that it is in everyone's interest, particularly the interest of new Federal employees, to get a bill this year, and to get a bill that comes out of the conference committee and can avoid a needless and destructive confrontation with the executive branch. To have a finished work product at the end of the year is a goal that I believe all members of this committee share.

With that in mind, we have to look at some of these recommendations. I have worked closely with your group and appreciate the working relationship we have had. I know you understand that if you accepted the capital accumulation plan and then had a full COLA and full retirement at 55 and some of the other things mentioned, the end result might be significantly more expensive as a percentage of payroll than the current plan, which would not lead us toward a bill as of the end of the year.

I think everyone understands that, and it is hard to choose between the different provisions. I find your testimony very helpful in outlining some of the reasons you feel the way you do.

Your organization, because of its nature, doesn't have too many members who would be immediately affected by the bill right now, is that correct?

Mr. LEDBETTER. Senator Gore, that is a very interesting question. I was talking with our consultant, Mr. Ruddock, the other day about that and I doubt very much if we have a single member right now who has come into the Postal Service since January 1984—most supervisors put in a few years in the business before they get promoted to supervisors. However, Mr. Ruddock tells me in 8 years, over half of all postal employees would be covered by the new system. I was surprised about that. I certainly have faith in Mr. Ruddock's——

Senator GORE [interposing]. You have a great big stake in making sure this new plan works well and efficiently. I may submit some other questions to you for your response in writing. I appreciate your appearance. Thank you, Mr. Chairman.

Senator STEVENS. Thank you very much, gentlemen. We do appreciate your coming. We will get back in touch with you.

[Mr. Ledbetter's prepared statement follows:]

TESTIMONY BY
DONALD N. LEDBETTER, PRESIDENT
NATIONAL ASSOCIATION OF POSTAL SUPERVISORS

Mr. Chairman, Members of the Committee: My name is Donald Ledbetter and I am President of the National Association of Postal Supervisors, an organization representing some 44,000 mid-level managers in the U.S. Postal Service. With me is Andrew E. Ruddock, a retirement consultant to our organization. We are pleased to be here today to offer our views on S. 1527, a bill to establish a new retirement system for postal and federal employees hired after December 31, 1983.

At the present time, we have very few members who would be immediately affected by S. 1527. The majority of supervisors are promoted from within the carrier and clerk craft unions in the Postal Service and not newly hired from outside industry. We are, however, deeply concerned about the new supplemental retirement program and not simply from the standpoint of future members. This retirement legislation will be the most important piece of pension legislation since the passage of the Employee Retirement Income Security Act in 1974 and will eventually create the largest retirement program in the country. We believe the federal government should be a leader in the development of sound personnel policies, particularly now since people are making career decisions based on more than just salary.

Mr. Chairman, we would like to congratulate you and particularly Senator Stevens for your diligence, hard work and leadership in this area. I personally can remember no other issue, with the possible exception of the Postal Reorganization Act, over which so much time, effort, discussion and debate have been expended. We began this process nearly four years ago with Senator Stevens and appreciate the cooperation extended to us throughout that time by Senator Stevens and his staff. You, Senator Stevens and Senator Eagleton did an excellent job in insuring that all interested parties had the opportunity to express their views. The public policy forums in particular held in late 1983 and 1984 gave a good, solid background on which to begin this debate.

We agree, Mr. Chairman, the time to move ahead on the development of a supplemental plan is now. Because of the wealth of information that is available, we think it is possible to develop a plan this year that meets the needs of employees, the employer and, in our case, the taxpayer as well. We have come a long way since those first meetings. Many of the concerns we expressed several years ago have been overcome by provisions of S. 1527.

In my testimony today, I would like to review some of the provisions of S. 1527 we support, some we do not and some specific recommendations for changes. Despite our continued opposition to Social Security coverage for any postal or federal employee, we recognize the reality of the situation and for that reason do support the three-tiered approach contained in your legislation. The combining of social security with a defined benefit supplement and a thrift plan is the best possible combination of prevailing practices in both the public and the private sectors.

We strongly support the use of the present Civil Service Retirement Fund for the financing of both the old and new systems. As you will recall, one of our major concerns in the Social Security debate was the drain on the Civil Service Retirement Fund if new entrants were totally cut off. That is not the case in S. 1527.

In general, we are also supportive of the disability provisions. The inclusion of Social Security disability benefits provides a higher replacement of predisability earnings if the employee meets the Social Security definition of disability. If the employee is regarded as disabled only for his or her job in government, the disability benefits remains about the same as now provided by the current system. We do not, however, see the advantage in having a third party administer the disability program outside government. The framework for the payment and distribution of disability benefits is already in place. Obviously the required coordination with Social Security would add to present administrative costs, but we think handling claims in-house would be less costly than contracting out that function and thereby paying profits to a private insurance company.

As I mentioned, we do have problems with some of the present provisions of S. 1527. First and foremost, we are concerned with the overall level of benefits. From our perspective, there is no reason to adopt a plan that costs 17% less, as a percentage of payroll, than the present Civil Service Retirement system. Social Security coverage has necessitated two different retirement programs, but in our opinion, the problems need not be exacerbated by making those differences so wide as to create sharp distinctions in what one employee receives over another.

An employee under the new system would naturally resent the prospect of receiving less retirement benefits than an older employee working side by side doing the same job. This would create unnecessary and harmful morale problems. In light of the findings by Hay Associates, as reported to the House Post Office and Civil Service Committee, there is no justification for the federal government to provide such a low-cost plan. As Hay noted, total federal pay and benefits are already 7.2% less than those in private industry. Hay further found the present employer cost of Civil Service Retirement benefits is less than the payroll cost of 25.1 percent or more for the top 10 percent of large employers in private industry.

The average retirement cost for the private sector we hear most often is 18.5% of payroll. However, that percentage takes in the mediocre and those private companies that have little or no retirement benefits for their employees. This brings us back to the basic argument on the role of the federal government. We believe the federal government should be a leader because of its size and the nature and importance of its work. The functions of government, in one way or another, impact on every person in this country every day. The federal government cannot nor should not be compared to a small computer company for instance. That company may do important work, but its role is not anywhere as varied nor as widespread as the role of government. In order for the federal government to effectively compete for quality employees, the government must provide a benefits package similar to that offered by the top companies in private industry not the average or mediocre.

Secondly, although we support the concept of a thrift plan, we do not think government's contribution should match 100% up to the first 5% of employee contributions. We object to the matching provision for several reasons. First, the prevailing practice in the private sector is to match 50% up to 6% of employee contributions. The costs for the higher government contribution in S. 1527 could be better used to improve the defined benefit portion of the plan. We recognize that one purpose of the thrift plan is to partially offset the tilt in Social Security since higher paid employees would undoubtedly participate to a greater extent than lower paid employees. However, we do not think higher paid and older employees should receive disproportionately higher share of the government's contribution through the use of the thrift plan than younger employees who are generally paid less. For instance, we believe the majority of postal supervisors could not afford to participate to any great extent in the thrift plan. The average salary for a supervisor is now about $30,000. In our opinion, it is difficult in today's society to have any additional income in which to invest at that salary level particularly if the supervisor is married and has a family.

We believe the overall purpose of the thrift plan should be to provide the "icing on the cake." Employees should not have to depend on the thrift plan for a decent retirement income. The thrift plan should be used to encourage employees to save and thereby provide extras during retirement not as a primary source of retirement income. Our recommendation is for government to match 50% employee contributions to the thrift plan up to 6%. This would benefit higher paid employees who could participate at a greater rate and still encourage employees at all levels of government to save. The tax deferred component would encourage people to save at either the 100% match or our preferred 50% match. This assumes the President's proposal to eliminate the tax deferred status of so-called 401k plans is not adopted in any tax reform measure. Removing the tax incentive from the thrift plan would make it considerably less attractive.

There are several changes we would like to recommend that would, in our opinion, improve S. 1527 for the government as an employer and for the employee. First, we strongly recommend an elimination of the 2% per year penalty for optional retirement before age 62. The prevailing wisdom behind the adoption of the present unreduced benefit at age 55 with 30 years service still applies. It was adopted, in part, to keep the workforce young and vigorous and to increase the opportunity for younger workers to move up the promotional ladder. It improves employee morale and productivity and has served both employees and the employer well. We support this policy.

It was reported as recently as September 4, 1985 in The Washington Post that CBS, Inc. is encouraging 2,000 of its employees who are at least age 55 and have 10 or more years of service to retire by November 29 of this year. To make early retirement more attractive, the benefits of employees who accept the offer will be computed as if they were five years older and had completed an additional five years of service.

During the Senate policy forum of February 16, 1984, A. Dale Stratton of the E.I. du Pont de Nemours and Company noted, "Despite the legislative trend which increases or eliminates a mandatory retirement age, employee choice continues moving in the other direction. Responding to employee requests, an unreduced benefit is now available at age 58 after 27 years of service." What du Pont has found over the last 10 years is that the "majority of employees retire between the ages of 58 and 62." The average age of employees retiring under the present Civil Service Retirement system is about age 61. It is with companies such as du Pont that the federal government must compete. According to a recent article by Peter W. Stonebraker in Compensation Review, "Compensation, and more particularly, benefits -- are more dynamic, visible and competitive than ever before." The federal government cannot afford to ignore this trend. Providing for an unreduced annuity at age 55 with 30 years service would cost in terms of percentage of payroll only 0.5% which is relatively small in relation to the benefits we believe it supplies.

Second, we believe there should be full cost-of-living protection. As presently drafted, S. 1527 would provide annual COLAs equal to the change in the CPI minus two percent. Assuming inflation was at 4% a year, under this provision, the retiree would lose 15% of his or her purchasing power over seven years. In 21 years over half would be lost. The primary purpose of a retirement plan is to maintain a retired employee and his or her dependents in a standard of living that is reasonably consistent with the income they enjoyed during pre-retirement years. While a thrift plan may help, it does not alleviate the need for full COLA protection. As noted by Dale B. Grant of the Martin E. Segal Company in the July 10, 1984 policy forum, "If inflation is high during the contribution period, the contributions made on early career salaries will have relatively little value in relation to final earnings. Second, if inflation is high during retirement, the annuity will be inadequate."

Again, I return to the competition the federal government faces. In a study conducted by Hewitt Associates of 577 small-to-large firms, 76% of the companies which granted a pension increase last year or which were considering granting one this year cited the cumulative effect of inflation as one reason and an effort to maintain a competitive position as another. We recognize providing full COLAs is costly and would add 3% of payroll to the cost of S. 1527, but we believe it is necessary to protect retirees on fixed incomes from the damaging effects of inflation.

Three, we recommend there be an improvement in the accrual rate contained in S. 1527. For a number of years, the present Civil Service Retirement system has assured adequate retirement income after a full career of 30 to 35 years. S. 1527 would not do that for new employees using the 1% accrual rate for each year of service. Social Security benefits plus the defined benefit supplement would be lower than current Civil Service annuites at all but the very lowest pay levels. In an example given by James A. Curtis of the actuarial consulting firm of Milliman & Robertson during the May 30, 1984 policy forum, the accrual rate for a "typical defined benefit plan" was 1.5% of final average salary per year of service. If, for cost reasons, a 1.5% accrual rate is too high, the Congressional Research Service estimates the accrual rate of S. 1527 could be increased to 1.2% for a cost of 2.3% of pay. To encourage career or long term employment, a slightly more costly alternative would be 1% for the first 10 years of service and 1.5% for years after 10.

Four, we recommend a retention of the high-three average salary to determine annuities. Robert D. Krinsky, President of the Martin E. Segal Company during the policy forum on December 13, 1983 gave an excellent reason why final average salary benefit formulas are advantageous. "While other methods have been used to adjust the benefit structure of retirement plans to recognize economic changes up to the point of retirement, basing benefits on final average salary appears to be the most systematic and equitable method of automatically protecting the real value of benefits in relation to rising salaries. Under this type of benefit formula the basic purpose of the retirement system -- to replace some portion of earnings, depending on length of service, in the event of old age, disability and death -- is directly related to existing economic conditions."

Obviously, basing annuities on a high-three average salary as opposed to a high-five average more closely reflects economic conditions at the time of retirement. A high-five average would reduce annuities by about 7%, yet retaining the high-three average would only increase the cost of the supplemental plan by about .9% of pay. Again, this is a relatively minor cost considering the financial hardship the high-five average would cause postal and federal employees.

Five, we strongly recommend the survivor benefit provisions of S. 1527 be improved. The inadequacy of this provision would leave many survivors nearly destitute as clearly shown in Exhibit 1. Assume a male employee dies at age 45 with 10 years of service and has a constant salary (average salary and final pay) of $30,000 a year. He is survived by a widow and no children. Under the present Civil Service Retirement System, the widow would receive a survivor annuity of $550.00 per month beginning immediately (22% of the high-three). Under S. 1527, her defined benefit would be $73 a month and would not begin until ten years after the death of her spouse when the employee would have been eligible to retire. This is 50% of the earned benefit reduced by 35% for age and another 10% to provide the survivor benefit.

We recognize under S. 1527 the widow would receive a benefit from the thrift plan if the employee participated which could begin immediately or later at her election, and that she would qualify for a Social Security survivor benefit when she reached age 60. However, under the present system, in addition to the survivor annuity of $550 a month, that same survivor would have income from any savings the employee had laid aside. Also, since the employee did not enter government service until he was 35, in all probability he had at least 40 quarters of Social Security coverage in private employment needed to give his widow a Social Security survivor benefit beginning at age 60.

Last, the survivor would receive under S. 1527 a life insurance payment of $32,000 (one year's salary plus $2,000), but this is no different than what she would receive under the present system unless the employee was one of the few who elected to waive life insurance. Obviously, we have given a worst-case example. But, it does clearly show that the survivor benefit provisions of S. 1527 are far below those of the present Civil Service Retirement system. We urge that S. 1527 be revised to give a surviving spouse an immediate benefit equal to 50% of the unreduced earned annuity.

We also recommend an elimination of the increase in the government's contribution to FEGLI, the Federal Employees Government Life Insurance program. The costs for employees is relatively minor and easily affordable and the government's contribution could be better used to improve defined benefits.

Finally, we recommend employees contribute 1.3% to the defined benefit supplement. This would make contributions of old and new employees nearly equal and would reduce government's cost by 1.1% of pay (the 1.1% amount is less due to refunds given to employees who leave before retirement age). We recognize it would be impractical for employees in both the old and new systems to contribute exactly the same amount due to the nature of Social Security contributions. But, we do believe the contributions, like benefits, should be as nearly equal as possible.

With all the changes we have suggested, the 20.8% government cost of S. 1527 would be increased to 24.9% of pay. In Exhibit 2, we detail those changes and the cost associated with each of them. The estimated costs for all the various items were supplied to this Committee by the Congressional Research Service of the Library of Congress. The final cost we reached is roughly equal to the cost of the present Civil Service Retirement system and is consistent with our policy of providing comparability and equity between old and new postal and federal employees. It is still less than the 25.1% payroll cost for the top 10% of large employers in private industry.

Before concluding our testimony, there are several issues that we would like to mention briefly. In a public hearing, it is impossible to discuss every aspect of such a complex piece of legislation, but we would like to draw your attention to several items. First, in regard to the question of election into the new system by pre-1984 employees, we recommed this decision be deferred for two to five years until the new plan is fully operational. It is almost impossible to provide the employee with all the information needed to make an intelligent election. In any event, the election process would be much simpler after the new system has been operational for some period of time. In testimony before the House Post Office and Civil Service Committee an Administrator of the Maryland State retirement system, which did provide a voluntary election, noted most employees regardless of whether they stayed in the old system or elected into the new, later thought they had made the wrong decision. Consequently, to minimize any confusion and controversy, we recommend this waiting period.

Second, we do not believe it would be wise for the thrift plan monies to be invested in the private sector. Taking money out of government and investing it in the private sector would add to the public debt. Also if private investments do poorly, the loss is borne entirely by the employee. This is unnecessary given the present 11% earnings rate of the Civil Service Retirement fund.

Third, we are somewhat concerned about the requirement for payments to amortize any supplemental liability that may be created. It is our hope this will be clarified in such way that postal rates will not be affected.

Four, in the case of a pre-1984 employee who separates from federal service but is later re-employed, we recommend that he or she remain in the old system.

Five, we think it is wrong to include salaries above the pay cap in the average salary because it bases an annuity on income the employee never had. Retirement programs are for income replacement. They should not be designed or used to correct other inequities.

Six, we urge the Committee to examine the administrative costs of S. 1527. The administrative costs of the present system are about 0.1% of pay, but given the complexities of coordination with not only Social Security, but outside entities as well (disability and thrift plan), the administrative costs of S. 1527 would be much higher than 0.1%.

Seven, the comparisons of replacement rates for the old Civil Service Retirement system and for S. 1527 ignore the fact that old Civil Service Retirement employee income would be much higher if the employee had saved and invested at least 5% of pay.

And, last, unvested amounts of government contributions to the thrift plan should not revert to miscellaneous receipts of the Treasury, but go back to the fund.

There are a number of technical problems we see in S. 1527 but they are relatively minor and we would be happy to get together with your staff to discuss them at a later date. Mr. Chairman, we appreciate the opportunity to offer our views on S. 1527 and want to reiterate our strong commitment to seeing a bill passed this year that is not only in the best interests of the people we represent, but the government as an employer and the American taxpayer. We would be happy to answer any questions.

EXHIBIT I

SURVIVOR BENEFITS UNDER S. 1527

Male employee, dies at age 45
10 Years Service
$30,000 Constant Pay

	$ 3,000.00	10% of $30,000, 1% accrual rate
-	1,050.00	35% reduction - 5% per year reduction (10 years service)
	$ 1,950.00	retirement before 62
-	195.00	10% reduction to provide survivor benefit
	$ 1,755.00	
-	877.50	50% reduction - survivor benefit is half
	$ 877.50	Divide by 12 months, benefit equals $73.00 per month

EXHIBIT II

RECOMMENDED CHANGES TO S. 1527

	Government Cost	
S. 1527 as introduced		20.8%
Age 55-30 retirement unreduced	+	.5%
Full COLAs	+	3.0%
Accural rate at 1.2%	+	2.3%
High-Three Average	+	.9%
Improvements to Survivor Benefits	+	.3%
Subtotal		27.8%
Change thrift plan match to 50% of 6%	-	1.6%
Eliminate FEGLI increase	-	.2%
Employees contribute 1.3%	-	1.1%
Revised government cost of S. 1527		24.9%

Senator STEVENS. Our next witness is Hon. John Erlenborn who represents the Chamber of Commerce of the United States.

Senator GORE. Mr. Chairman, I would like to welcome this witness as a former colleague in the House, one whose voice was widely respected on both sides of the aisle in the House of Representatives' Although we disagreed from time to time, I and all of my colleagues recognize the enormous amount of study and effort that Congressman Erlenborn has put into these subjects. I certainly will find benefit in his comments here.

TESTIMONY OF JOHN N. ERLENBORN, REPRESENTING THE U.S. CHAMBER OF COMMERCE, ACCOMPANIED BY JAMES A. KLEIN, MANAGER OF PENSION AND EMPLOYEE BENEFITS, U.S. CHAMBER OF COMMERCE

Mr. ERLENBORN. Thank you, Senator, for those kind comments. Thank you, Mr. Chairman, for the opportunity to appear here today and represent the U.S. Chamber of Commerce.

Mr. Chairman and members of the committee, I will not read the entire statement. I hope the entire statement will be included in the record. For the purpose of saving time, I will read portions of it.

My name is John Erlenborn. I am a partner in the law firm of Seyfarth, Shaw, Fairweather & Geraldson. I am pleased to appear here today on behalf of the U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce, and trade and professional associations. Accompanying me today is James A. Klein, manager of Pension and Employee Benefits for the chamber.

As you may know, during my 20 years in the House of Representatives, I took a keen interest in developing a rational retirement policy for both the public and private sectors. That interest and involvement have continued since my retirement in January to practice law as a specialist in employee benefit issues. Because of my longstanding interest and involvement in these matters, it is a particular pleasure to share with you our perspective on reform of the civil service retirement system. Congress has quite a challenge before it to enact by the end of this year a new retirement system for Federal employees hired after 1983.

Senator Stevens and Senator Roth are both to be commended for developing a comprehensive and thoughtful bill, S. 1527. This bill seeks to address the important questions that should be decided by year-end in order to keep post-1983 Federal hirees from remaining in limbo regarding their retirement program. While it is important for Congress to act expeditiously, it is also crucial to develop a system that balances the need of Federal workers to be ensured adequate retirement coverage and the need of taxpayers to pay for an equitable and reasonably priced system.

We wish to share our thoughts on the Stevens-Roth plan and on the development of a new retirement system for recently hired workers within the context of reform of the civil service retirement system.

At the outset, I should state that the center of the chamber's position on the Federal retirement system is the concept that it should be modified to approximate more closely its private sector counterpart.

As a leading supporter of the private pension system and a principal author of ERISA, I believe that much can be learned from the private system for constructing a reasonable and financially sound Federal retirement structure.

In at least two respects, cost of living adjustments and early retirement, the CSRS differs substantially from the private sector retirement system. These are the two issues upon which my remarks will mainly focus.

In large part due to the COLA and early retirement features of the civil service retirement system, most Federal retirees receive more generous benefits than those received by most private sector retirees whose tax dollars substantially support the Federal retirement system.

COLA's were first authorized for Federal pensions in 1962. The original civil service pension COLA was triggered when inflation exceeded 3 percent. Since 1962, the Federal pension COLA has been on a veritable roller coaster.

The COLA's in the Federal retirement system have been indexed fully to increases in the Consumer Price Index since 1966. By contrast, the private pension system rarely pays cost-of-living increases. In the private sector, a defined benefit pension plan provides exactly what its name suggests—a defined benefit amount—frequently with no adjustments for inflation.

Some private plans do contain inflation adjustments and other companies increase benefits voluntarily. Social Security also adjusts for inflation. However, a U.S. Department of Labor survey indicated that in 1982, only 3 percent of all private plans contained automatic inflation adjustments. Moreover, these adjustments were limited generally to 3 percent per year, rather than the open-ended adjustment that the Federal Government pays its retirees.

There is no question that basic benefits should be increased during periods of inflation, but retired persons should not receive greater cost-of-living protection than working people. That is what has happened and will happen again this coming year as Federal pay is frozen.

In 10 of the years from 1971 to 1983, persons drawing Federal retirement benefits received larger annual increases than wage earners gained in union negotiations in private industry. While these working Americans realized an average annual gain of 60 percent of the CPI increases in their paychecks, the retired Federal worker gained 100 percent.

The full CPI adjustments paid to Federal pensioners also result in the anomalous situation that some retirees can receive more in annual Federal retiree benefits than the salaries earned by the individuals filling the positions formerly held by the retirees. We must restore economic equity between working and nonworking generations.

How then should Congress deal with COLA's which in large part are responsible for the explosive growth in spending on all Federal pensions from $2.7 billion in fiscal year 1970 to over $23 billion this year? One way might be to consider something akin to the COLA stabilizer which I proposed in the FAIR—and that is an acronym for Federal annuity and investment reform, civil service retirement legislation that I introduced in the 98th Congress. This proposal bases the COLA on the lesser of the increase in the General Schedule increase or the CPI. This reference amount is then applied to the first $10,000 of pension, an amount roughly equal to the maximum benefit a new Social Security recipient would receive in 1985. A more limited COLA adjustment is then granted on pension amounts above $10,000.

Another alternative is indicated in the Stevens-Roth plan whereby annual COLA's would be paid at 2 percent below the rate of inflation as measured by the CPI.

It should be noted that either proposal would help achieve the goal of bringing Federal employees to the level of private sector employees. Even with these changes from the current civil service retirement system, however, Federal retirees would have a more generous retirement plan than is found in the private sector.

It is important when considering a COLA as part of the new Federal retirement system, to compare the system with prevailing practices in the private sector, not with the current system, because the participants of the new system will, like their private sector counterparts and unlike Federal employees hired prior to 1984, have Social Security COLA protection.

The provision of the civil service system that permits an unreduced annuity for Federal employees retiring at age 55 after 30 years of service often has been in the eye of the storm of controversy surrounding Federal pensions.

Therefore, an explanation of the early retirement features of private pension systems is in order to develop a workable and fair early retirement feature.

In the private pension system, early retirement is more commonly available at age 62 than age 55 and even then, the retirement benefit generally is reduced for each year the retiree is under age 65. This also is the case with Social Security benefits.

Phasing in reduced benefits for retirees between the ages of 55 and 65 would bring the Federal retirement system into closer alignment with private sector retirement practices. The chamber supports this reform and urges the Congress to do likewise.

The Federal Government Service Task Force, the congressional caucus, claimed in a fall 1984 report that both private and Federal workers retire on average at age 61. The task force quoted Office of Personnel Management figures showing that in 1982, civil service retirees on the average left at age 60.7 with 28 years of service.

Unfortunately, these figures do not tell the whole story, but let us not lose sight of the forest by looking at the trees, debating statistics when the policy of unreduced early pensions is the problem. If the policy of early retirement is a privilege paid for mainly by taxpayers and yet not enjoyed by them, then where is the equity in continuing that policy? Indeed, if Federal retirees retire later than assumed, why oppose change?

For the record, certain points should be made about the retirement age issue. First, the Bureau of Labor Statistics' Office of Employment and Unemployment Statistics does not collect data on average private sector retirement ages due to definitional problems. For example, is a rehired annuitant retired? Thus, there is no reliable private sector average retirement age data published by the Government.

Second, let us beware of averages that mask significant data. The average age of retiring Federal employees from 1973 to 1982 was 61.1 years, according to table 15 on page 31 of the Congressional Research Service report, "Background on Civil Service Retirement System." What this table does not state is that, according to OPM, about 39 percent of the retiring Federal employees retire within 1 year of attaining age 55 with at least 30 years of service.

Further, the 61.1 age refers only to optional retirement, those with age-service of 55/30, 60/20 and 62/5. It does not include retirement ages for disability, involuntary, deferred, mandatory or special situations—hazardous employment, Members of Congress, and so forth.

The figure quoted by the task force is only for optional retirement. It represents 69.3 percent of the 85,000 retirees in 1982. As a matter of fact, 25 percent of the 1982 civil service retirees left Federal service at an average age of 52. Both my FAIR proposal of the 98th Congress and S. 1527 are directed at bringing the early retirement features of the new Federal system into closer conformity with private sector practices.

Under my FAIR proposal, current employees as well as future employees would be able to retire under the same age-service provisions as under present law, but the amount of benefits based on service after the year of enactment would be subject to a reduction factor of 2 percent for each year under normal retirement age.

The 2-percent rule would not reduce the amount of an employee's benefit which is accrued prior to the year of enactment.

The Stevens-Roth plan also reduces an annuity for early retirement, reducing benefits for retirement before age 62. Earlier this year, the Reagan administration also proposed a phase-in of reduced benefits for retirees between the ages of 55 and 65.

I am not suggesting that the reduction factor must be 2 percent as it was proposed in the FAIR legislation. I am suggesting some reduction factor be considered. Social Security reduces benefits by 6⅔ percent for every year under age 65. The Congressional Research Service reports on page 42 of its December 1984 study for the House Post Office and Civil Service Committee that a full actuarial reduction would reduce payments by 6 or 7 percent per year. However, private pension plans often reduce employees' accrued pension benefits by about 4 or 5 percent a year if they retire early.

Employees should not be prevented from retiring early, but neither should they be encouraged to leave earlier by an excessively generous provision. I believe a proposal to moderate early retirement costs will work to the benefit of our Government and its employees.

The employer cost of the current civil service system is an unacceptably high percentage of the total Federal payroll. Congressional Research Service estimates that the cost is 25 percent of pay. An independent study conducted for OPM found the cost to be 28 percent of payroll, as did the study by the Grace Commission.

In the private sector, however, the employer costs are much less. The same study prepared for OPM, mentioned above, found that private pension costs were 18 percent of pay, while the Grace Commission placed the figure at 17 percent. These studies looked at the norms in medium and large companies that have pension plans. Other estimates, including the U.S. Chamber's annual Employee Benefits Survey and the U.S. Department of Commerce's Survey of Current Business, both of which look at the entire spectrum of business sizes across the economy including those with and without pension plans, revealed the cost of retirement plans at between 4 and 5 percent of payroll.

The point is clear. By any measure, the cost of the present Federal retirement system is inordinately high. The new system must seek to bring the normal cost of the retirement plan into accord with normal costs in the private sector as a matter of fiscal responsibility toward the taxpayers who support the system, as a matter of equity between Federal and non-Federal workers and as a matter of honesty toward the Federal employees who are relying upon the ability of the Government to pay the benefits they are being promised.

The GAO report found, among the surveys it used to compile its report, that between 64 and 69 percent of private sector plans were integrated with Social Security. The degree to which the Social Security tilt is offset and the method by which it is done vary among different pension plans. However, the extensive data compiled by the studies which GAO analyzed clearly suggest that integration of Social Security and pension benefits is the predominant practice in the private sector. To the extent that the new system is not integrated with Social Security, it is departing from the typical private sector practice.

Federal employees covered by the current civil service system are required to contribute to their pension plan. According to GAO data, this is clearly contrary to the common practice in the private sector, where between 78 and 93 percent of the pension plans are fully paid by the employer.

Employer sponsorship, however, does not preclude the opportunity for voluntary employee contributions. Capital accumulation plans are a typical feature of comprehensive retirement programs in the private sector. Whether it is in the form of a salary reduction 401(k) plan, a thrift plan or other type of capital accumulation plan, the new system should encourage employees who wish to do so to help save for their retirement. This will provide Federal employees the same opportunity which many private sector employees enjoy—to contribute toward their retirement income security—and will discourage the financial pressure on the Federal Government in determining its proper level of contributions.

The Stevens-Roth plan, by not requiring the employee contributions to the defined benefit plan but by establishing a voluntary capital accumulation plan, resembles common features of private sector retirement programs.

In the civil service system, employees are vested after 5 years. The GAO report demonstrates that an overwhelming number of private sector pension plans provide for cliff vesting after 10 years. A small percentage of plans provide for either cliff vesting after a period other than 10 years or graduated vesting.

The committee should be aware that the 5-year vesting feature of the defined benefit portion of the Stevens-Roth plan is not the prevalent practice in the private sector. In the absence of any evidence showing that vesting rules should differ for the private sector and the Federal Government, the new Federal system should align itself more closely with the typical private practice.

Our Nation's private sector pension system provides an ideal model for Congress to use in developing a pension system for newly hired Federal employees. The mandatory inclusion of Federal employees in the Social Security system places them in the same position as private sector employees and adds further credence to the notion that a private sector type of retirement program should be developed.

Several features of the Stevens-Roth plan resemble common features of private sector retirement plans. The chamber notes and appreciates that fact.

In other respects, the chamber notes that features of the proposal differ from common industry practices and encourages the committee to bring the bill closer to conformity with private sector practices.

Congress has before it a difficult challenge, but also a unique opportunity to fashion a retirement system for newly hired workers. The challenge is to draft a balanced and reasonably priced system. The opportunity, however, is to create an entirely new system for post-1983 hired Federal employees and by emulating common features in the private sector system, avoid some of the troublesome aspects of the civil service system.

I hope my comments will assist you in meeting that challenge and opportunity. Thank you.

Senator STEVENS. Thank you very much. My only question would be: In reference to the private sector, you used the private sector as a whole, not just those major employers with whom the Federal Government competes in attracting and keeping its employees, isn't that true?

Mr. ERLENBORN. I have used both, Senator. I quoted the cost as found for the medium and large size private sector businesses or private sector pension plans and then the overall cost, including all businesses, those that maintain pension plans, those that are smaller and less costly. So I actually used both figures.

Senator STEVENS. But if you use total compensation in dealing with those larger employers, their total compensation package far exceeds that of the Federal Government today, including retirement.

Mr. ERLENBORN. Senator, I don't know those figures, but I am familiar with some that have been quoted. For instance, the U.S. Chamber's cost of fringe benefits or employee benefits in its latest report, which was several years ago, was about 36 percent, but you have to look at those figures. That 36 percent includes social security taxes, unemployment compensation, workers' compensation, paid vacation, and so forth.

So to relate the figures, I think you better look at how they are composed. I think many people have a very incorrect attitude as to the level of employee benefits so they see that 36-percent figure and don't understand it includes things like workers' compensation.

Senator STEVENS. I agree. I am looking at the average compensation of Federal employees which is no longer comparable with the private sector. We are told that we must keep our retirement system comparable with the private sector. Let's say the cost is 20 percent. This is just assuming a fair comparison would be 20 percent if we ought to keep ours at 20 percent, well, that is 20 percent of a payroll which by definition is substantially less than the payroll, on the average,of the private sector.

Members of Congress alone—I used to carry that little card with me—we were about 76 percent adjusted to the CPI since the period since 1970. The private sector is about 175 percent.

Mr. ERLENBORN. Senator, I think it would be a mistake if we were to use the pension system as a substitute for current salary. I thoroughly agree with you. We are not paying Federal workers sufficiently, and in my 20 years in Congress, I can't recall ever voting against a pay increase bill. I came from a very safe district I was able to do that. [Laughter]

I can tell you from personal experience, when I came to Congress in 1965, the pay was $30,000. It is now $75,000. It has gone up about 2½ times. The house that I bought would now cost about six times what I paid for it in 1965. The pay for Members of Congress, and this is true as well for the Federal employees generally, just has not kept up. I don't think that is an excuse for fashioning a pension plan that is not in keeping with the norms in the private sector.

I would say increase the pay. I think the employees would rather have the cash in their pocket than a promise for the future.

Senator STEVENS. I agree with you. I think the retirement system is, in fact, an inducement for retention, even though there is this dissatisfaction with the current compensation. The chamber has made a substantial contribution in the past, and we will continue working with you in the future. We thank you, John, for your presence. Senator Gore?

Senator GORE. Thank you, Mr. Chairman. The Chairman really started the line of questioning that I wanted to pursue with you. He has made my job a little bit easier. I just want to follow up on a few loose ends here.

You are speaking for the chamber here. Does the chamber dispute the findings of recognized authorities, such as Hay Associates, the General Accounting Office and other studies, that the total compensation package for Federal employees is significantly less than for their counterparts in the private sector?

Mr. ERLENBORN. I cannot speak for the chamber on that because it is not included in the statement, but I would doubt very much that anyone would dispute that finding.

Senator GORE. All right. You have said the logical basis of your position is that the design of the pension system should be aligned with that of the private sector. Would it be your position also that the pay of Federal employees should be significantly raised in order to align it, with the private sector?

Mr. ERLENBORN. Very definitely.

Senator GORE. Is that the chamber's position?

Mr. **Erlenborn**. I don't know if that is the chamber's position, and I think that might be another committee that would have to meet and——

Senator **Gore** [interposing]. We don't have the luxury of looking at it in a vacuum. In considering the impact of these proposed changes on recruitment and retention, we have to look at it in its proper context. I am wondering if your associate there from the chamber—excuse me for not remembering your name.

Mr. **Klein**. James Klein.

Senator **Gore**. Thank you. You are the head of the Pension Benefit——

Mr. **Klein** [interposing]. Pension and Employee Benefits.

Senator **Gore** [continuing]. For the chamber. So you look at the overall package, don't you?

Mr. **Klein**. Mr. Erlenborn was correct in that pension issues move their way through the process in the chamber through the employee benefits committee structure to the board of directors. There is no other entity within the chamber, per se, that takes up the issue of Federal pay packages.

Senator **Gore**. Just as a matter of common sense then, wouldn't you agree if you have an overall package that is lower in Government service than for the private sector, and then you take the one out of three components that is attractive and lower it down to the average in the private sector, the net effect would be to significantly increase the disparity and further lower the total compensation package for Federal employees compared to their counterparts in the private sector? That's logical, isn't it?

Mr. **Erlenborn**. Senator, let me repeat, in answer to your question, what I told Senator Stevens; that is, if you want the total compensation package to be comparable, the elements should be comparable. You shouldn't offset poor pay by putting in an excessively generous pension system. If you do that, and that is what we have done, you are following the worse practices of the State and local public pension systems, and that is to substitute benefit increases for pay increases, not funding them and passing that burden on to future generations. We have done that with our civil service retirement system.

Over half a trillion dollars in unfunded past service liabilities. We didn't even know this until a few years ago when I was successful in getting a bill through that required all our Federal pension systems to make an annual, ERISA-type report of unfunded past service liabilities. Now we know our Federal pension systems as a whole, military, civil service—leaving Social Security out all together, I don't count that as a Federal pension system—have unfunded past service liabliities far in excess of $1 trillion.

I think you have to look at that past practice and say it was wrong and don't make that same mistake in the future by having a system that is too generous and is not properly funded.

Senator **Gore**. I don't want to explore in depth disputes over terminology that characterize these comparisons, but I do want to note that S. 1527 provides for fully funded pension benefit, and I also want to note that the internal logic of your personal position, while subject to disagreement, is consistent with when your call for comparability in pay.

I am not sure the internal logic of the chamber's position is consistent, simply because we don't have a presentation of the other essential elements, if one wishes to view the problem in its entirety and look at this part of it in its proper context.

Since you call for alignment with the private sector in pension design, I find it surprising that you want to shift from 5-year vesting to 10 because we heard from GAO that the trend in the private sector is in the opposite direction. If that is the case, isn't S. 1527 designed appropriately on that point?

Mr. ERLENBORN. First of all, I think the predominant practice in the private sector is still 10-year vesting.

Senator GORE. At the current time.

Mr. ERLENBORN. At the current time. I fully expect there is going to be legislation passed before too many years that will change that to 5-year cliff vesting. I should think you should conform the Federal civil service system with the private system at that time. But let me also warn——

Senator GORE [interposing]. Not until then? Should we just wait until a simple arithmetical majority of the private sector gets there or should we take a leadership position and see where the smart ones are going and design for the future or should we just wait until an arithmetical majority in the private sector get there?

Mr. ERLENBORN. I am speaking personally now, not for the chamber. I think the move to earlier and earlier vesting, though very attractive, has some hazards. In many cases, what you are doing is providing severance pay. The earlier you have your vesting, the smaller the benefit; therefore, if you had, let's say, 5-year vesting or 2 or 3-year vesting, when someone leaves with that short term of service with a vested benefit, they are going to cash it out and they are going to spend it, and it no longer really becomes part of their pension planning.

I think if you want to have a severance pay plan, install one instead of using your pension plan to provide severance pay. The earlier the vesting, the more chance that is what you are doing.

Senator GORE. But you don't really feel strongly about the difference between 5 and 10 year vesting?

Mr. ERLENBORN. I think the trend is toward 5. I don't feel terribly strongly about it, no.

Senator GORE. That is helpful to us. You indicated you have serious questions about the studies indicating that the typical or average retirement age in both the private and public sector is 61; but just for the record, neither you nor the chamber have any studies or any evidence to indicate otherwise, do you?

Mr. ERLENBORN. Other than what was cited in the statement, I'm not aware of it.

Senator GORE. In one of the excellent forums that our chairman put together last year before I was a member of this committee, I believe there was testimony from a representative of duPont that their average retirement age fell somewhere between 58 and 62. I can't disagree with you that the evidence is less than comprehensive in this area, but what evidence is available does seem to support the study indicating a comparable figure in both the public and private sector. That surprises some people, but that is what the evidence seems to indicate. Just a couple more questions, briefly.

Senator Eagleton who is, of course, a student of these subjects, points out as the premise of a couple of questions he wants me to ask here that there are other reasons for closely examining the proposition that this plan ought to be exactly comparable to what exists in the private sector. One of them has to do with longevity.

As a theoretical matter, if you have a pension plan in which length of service is a key factor in determining the level of retirement benefits, then the higher the average length of service is, the higher the retirement benefits would be, correct?

Mr. **Erlenborn**. Correct.

Senator **Gore**. So if the cost of a particular plan is higher than average in part because its employees covered retire with higher than average length of service, then to the extent one places a subjective value on longevity, it is not quite fair to criticize the higher cost which is attributable to that factor, correct?

Mr. **Erlenborn**. Let me amend my rather hasty agreement as to your first comment. The cost would be higher for a pension system if you have average length of service that is longer only, I believe, if you have a formula like you have in civil service where you earned at a higher rate in your later years. If it is a level of 1 percent or 1.5 percent per year service regardless for every year, and if you have the same number of employees working, you are going to be accruing those benefits at the same rate regardless of the individual's length of service. I think it is a function of formula for determining benefits that would make it more costly.

Senator **Gore**. You do recognize that longevity——

Mr. **Erlenborn** [interposing]. It's a factor in the current system.

Senator **Gore**. And something to be desired, isn't it, generally speaking?

Mr. **Erlenborn**. It depends from what standpoint you are talking.

Senator **Gore**. From a standpoint of efficiency.

Mr. **Erlenborn**. I have had some experience, vicarious experience, with the civil service system and the difficulty in getting rid of people who are maybe less than fully productive in the civil service system. So longevity in that case is not to be desired, no.

Senator **Gore**. I understand what you are saying. Of course, that is clear. As a matter of general policy, most employers like to have longevity. Assuming careful and good choices in hiring and an ability to attract quality employees, I am sure in your congressional office you certainly found the benefits of avoiding start-up training costs and high turnover and so forth—longevity is a virtue, generally speaking, isn't it?

Mr. **Erlenborn**. As a matter of fact, in the pension field, it was the rationale for pension plans. Long service was rewarded with a pension.

Senator **Gore**. So we want to promote longevity. To the extent you have a higher length of service in the Government and that affects the benefit levels, that is a mitigating factor in any criticism, or should be a mitigating factor in any criticism of a higher average cost associated with that higher longevity.

Mr. **Erlenborn**. I can endorse longevity, but I would like that to extend beyond age 55 with 30 years, because if we encourage those long-term employees who are still young enough to be useful, if we encourage them to leave the Federal Government with these early retirement benefits and then with the full COLA protection, we are making the system much more expensive than if we utilized these long service employees until they reached a normal retirement age. There is a feature in the current system that is working counter to the point that you make.

Senator **Gore**. Again, the figures we cited earlier which you don't have evidence to dispute, indicate that the average retirement figure is roughly comparable in both the public and private sector.

Mr. **Erlenborn**. You may recall, I cited——

Senator **Gore** [interposing]. Thirty-nine percent.

Mr. **Erlenborn**. Thirty-nine percent of retiring employees retire within the age of 55——

Senator **Gore** [interposing]. I did hear that. I think that is worth noting. Can you tell me what the average length of service is for employees retiring under private sector pension plans?

Mr. **Erlenborn**. I have no idea what that figure is.

Senator **Gore**. I wonder if you or your colleague could provide that for the record?

Mr. **Erlenborn**. We will certainly try to.

[The information referred to follows:]

Table III.6

The Cumulative Distribution of Years of Service by Age: "ERISA" Workforce[a] and Nonagricultural Wage and Salary Workers, May 1983

	Years of Service with Employer				
AGE	15 or more	10 or more	5 or more	one or more	All tenures
			Nonagricultural Wage and Salary Workers		
All Ages	15.6%	26.8%	45.4%	80.6%	100.0%
less than 25	b	b	7.3	59.3	100.00
25 to 34 years	1.2	10.8	37.3	80.2	100.00
35 to 44 years	18.9	36.9	57.8	86.6	100.00
45 to 54 years	36.1	51.5	69.9	91.6	100.00
55 to 59 years	45.5	60.1	75.5	91.7	100.00
60 to 64 years	46.5	64.2	79.1	94.4	100.00
65 years or more	35.6	52.3	69.9	92.5	100.00
			ERISA Work Force		
All Ages	23.1%	39.5%	64.9%	100.00%	100.00%
25 to 34 years	1.6	13.9	47.2	100.00	100.00
35 to 44 years	22.7	44.1	68.2	100.00	100.00
45 to 54 years	40.5	57.3	77.3	100.00	100.00
55 to 59 years	51.0	66.6	83.1	100.00	100.00
60 to 64 years	51.5	69.8	85.0	100.00	100.00

SOURCE: Employee Benefit Research Institute tabulations of May 1983 EBRI/HHS CPS pension supplement.

[a] The "ERISA" work force consists of workers age 25 to 64 working 1,000 hours or more per year with at least one year on the job.

[b] Number of workers too small for rates to be calculated reliably.

Senator GORE. Thank you. Do you know whether or not it is prevailing policy in the private sector to grant retirement credit for military service?

Mr. ERLENBORN. No; that is not a practice.

Senator GORE. I am sure it is not. Would you recommend the Government discontinue that policy? Let me add quickly, I wouldn't. I am wondering what your recommendation would be.

Mr. ERLENBORN. I don't know if this is still the law, but for a long time, there was double counting of some of those years of service. People who were in the active military reserve, that is, taking training——

Senator GORE. Let's get to the nub of the issue, though. What do you think about that, should that be discontinued?

Mr. ERLENBORN. No; I don't think so. I am enjoying my pension today, including the 2 years credit I got for being in the Navy.

Senator GORE. It is a good policy——

Mr. ERLENBORN [interposing]. I personally think so, yes.

Senator GORE. It is good, as a matter of public policy, if you have military service and Government service. I am sure there are some people who disagree with that, but I think the overwhelming majority of American citizens would say, yes, that seems to be appropriate.

Mr. ERLENBORN. As long as it doesn't result in what some people call double-dipping.

Senator GORE. But, again, that is an assymetry and to the extent that adds to longevity, it should affect one's analysis of these payroll cost numbers to the extent they are affected by the higher longevity.

Do you support the administration's recently announced position against 401(k) plans—this is a premise for a followup. I assume you do, is that correct?

Mr. ERLENBORN. No, the chamber, I think——

Mr. KLEIN [interposing]. The chamber is very much opposed to that.

Mr. ERLENBORN. Speaking personally, I would be also. Again, also personally, I do believe, however, the maximum contribution payments could certainly be reduced below the $30,000 that they are today. That, of course, was in the President's plan, the $8,000 limitation on the voluntary contribution.

Senator GORE. Do you differ with the chamber on this point?

Mr. ERLENBORN. I probably differ with the chamber on the reduction. I think the chamber position is probably to continue on 401(k) without any change.

Senator GORE. Because of the foregone revenue flowing from the tax deferral aspect of such plans?

Mr. ERLENBORN. Exactly. I think——

Senator GORE [interposing]. How would you balance those competing interests in S. 1527?

Mr. ERLENBORN. You mean with the savings plan, 401(k) type plan?

Senator GORE. Yes.

Mr. ERLENBORN. You would have to have a contribution level that would be considerably lower than the current level of 401(k) today, which is $30,000. So I think you balance those considerations by having a thrift plan, a savings plan, but with maximum contribution levels that are within our ability to afford.

[Mr. Erlenborn's prepared statement follows:]

STATEMENT
on
CIVIL SERVICE PENSION REFORM
before the
SENATE GOVERNMENTAL AFFAIRS COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
John N. Erlenborn
September 9, 1985

Mr. Chairman and members of the Committee, my name is John N. Erlenborn and I am a partner in the law firm of Seyfarth, Shaw, Fairweather & Geraldson. I am pleased to appear here today on behalf of the U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce and trade and professional associations. Accompanying me today is James A. Klein, Manager of Pension and Employee Benefits for the Chamber.

I serve on the Chamber's Labor and Employee Benefits Committee and on several of that Committee's councils and task forces which develop policy on labor and employee benefits matters.

As you may know, during my 20 years in the House of Representatives, I took a keen interest in developing a rational retirement policy for both the public and private sectors. That interest and involvement have continued since my retirement in January to practice law as a specialist in employee benefit issues. Because of my long-standing interest and involvement in these matters, it is a particular pleasure to share with you our perspective on reform of the Civil Service Retirement System (CSRS). Congress has quite a challenge before it to enact by the end of this year a new retirement system for federal employees hired after 1983.

Senator Stevens and Senator Roth are both to be commended for developing a comprehensive and thoughtful bill, S. 1527 (the "Stevens/Roth plan"). This bill seeks to address the important questions that should be decided by year-end in order to keep post-1983 federal hirees from remaining in limbo regarding their retirement program. While it is important for Congress to act expeditiously, it also is crucial to develop a system that balances the need of federal workers to be ensured adequate retirement coverage and the need of taxpayers to pay for an equitable and reasonably priced system.

We wish to share our thoughts on the Stevens/Roth plan and on the development of a new retirement system for recently-hired workers within the context of reform of the CSRS. At the outset, I should state that the center of the Chamber's position on the federal retirement system is the concept that it should be modified to approximate more closely its private-sector counterpart.

As a leading supporter of the private pension system and a principal author of ERISA, the Employee Retirement Income Security Act of 1974, I believe much can be learned from the private system for constructing a reasonable and financially sound federal retirement structure. In at least two respects — cost-of-living adjustments (COLAs) and early retirement — the CSRS differs substantially from the private sector retirement system. These are the two issues upon which my remarks will mainly focus.

In large part due to the COLA and early retirement features of the CSRS, most federal retirees receive more generous benefits than those received by most private sector retirees whose tax dollars substantially support the federal retirement system.

Cost-of-Living Adjustments (COLAs)

COLAs were first authorized for federal pensions in 1962. The original civil service pension COLA was triggered when inflation exceeded three percent. Since 1962, the federal pension COLA has been on a veritable roller coaster.

The COLAs in the federal retirement system have been indexed fully to increases in the Consumer Price Index (CPI) since 1966. By contrast, the private pension system does not match these cost-of-living increases. In the private sector, a defined benefit pension plan provides exactly what its name suggests--a definite benefit amount--frequently with no adjustments for inflation. Some private plans do contain inflation adjustments, and other companies increase benefits voluntarily. Social Security also adjusts for inflation. However, a U.S. Department of Labor survey indicated that in 1982 only three percent of all private plans contained automatic inflation adjustments. Moreover, these adjustments were limited generally to three percent per year, rather than the open-ended adjustment that the federal government pays its retirees.

There is no question that basic benefits should be increased during periods of inflation, but retired persons should not receive greater cost-of-living protection than working people. Yet, that is what has happened and will happen again this coming year as federal pay is frozen and pension benefits rise.

In 10 of the years from 1971-1983, persons drawing federal retirement benefits received larger annual increases than wage earners gained in union negotiations in private industry. While these working Americans realized an average annual gain of 60 percent of the CPI increases in their paychecks, the retired federal worker gained 100%.

The full CPI adjustments paid to federal pensioners also result in the anomalous situation that some retirees can receive more in annual federal retiree benefits than the salaries earned by the individuals filling the positions formerly held by the retirees. We must restore economic equity between working and nonworking generations.

How then should Congress deal with COLAs, which in large part are responsible for the explosive growth in spending on all federal pensions from $2.7 billion in Fiscal Year 1970 to over $23 billion this year? One way might be to consider something akin to the "COLA Stabilizer" which I proposed in the FAIR (Federal Annuity and Investment Reform) civil service retirement legislation I introduced in the 98th Congress. This proposal bases the COLA on the lesser of the increase in the general schedule increase or the CPI. This reference amount is then applied to the first $10,000 of pension, an amount roughly equal to the maximum benefit a new social security recipient would receive in 1985. A more limited COLA adjustment is then granted on pension amounts above $10,000.

Another alternative is indicated in the Stevens/Roth plan whereby annual COLAs would be paid at two percent below the rate of inflation as measured by the CPI.

It should be noted that either proposal would help achieve the goal of bringing federal employees to the level of private-sector employees. Even with these changes from the current CSRS, however, federal retirees would have a more generous retirement plan than is found in the private sector. For most private sector retirees, Social Security COLAs are the only inflation adjuster built into the retirement income formula. Benefit increases in private sector plans are typically on an ad hoc basis, depending largely on the available funds in the plan. Many private sector retirees have no private pension coverage at all.

It is important when considering a COLA as part of the new federal retirement system, to compare the system with prevailing practices in the private sector -- not with the current CSRS -- because the participants of the new system will, like their private sector counterparts and unlike federal employees hired prior to 1984, have Social Security COLA protection.

Early Retirement

The provision of the CSRS that permits an unreduced annuity for federal employees retiring at age 55 after 30 years of service often has been in the eye of the storm of controversy surrounding federal pensions. Therefore, an explanation of the early retirement features of private pension systems is in order to develop a workable and fair early retirement feature.

In the private pension system, early retirement is more commonly available at age 62 than at age 55, and even then, the retirement benefit generally is reduced for each year the retiree is under age 65. This also is the case with Social Security benefits.

No one can argue reasonably that individuals who have worked hard and who have looked forward to the comfort and security of retirement years should be denied the benefits they have earned. However, the only adequate explanation for the discrepancy in retirement ages between federal and non-federal retirees is that the availability [illegible] full benefits at age 55 is a powerful incentive for federal employees to retire at this early age. This practice denies the federal government the services of some of its most capable and experienced workers and requires the taxpayers to subsidize pensions for lengthy periods.

Phasing-in reduced benefits for retirees between the ages of 55 and 65 would bring the federal retirement system into closer alignment with private sector retirement practices. The Chamber supports this reform and urges the Congress to do likewise.

At this point a discussion of some of the myths and facts of retirement age in the federal sector is in order so that the early retirement features may be understood better and put into proper perspective. Some dismiss the matter of early retirement as inconsequential since they believe that federal employees retire at close to the retiring age of private sector workers. The Federal Government Service Task Force, a congressional caucus, claimed in a Fall 1984 report that "both private and federal workers retire, on average, at age 61." The Task Force quoted Office of Personnel Management (OPM) figures showing that in 1982 CSRS retirees on the average left at age 60.7 with 28 years of service.

Unfortunately, these figures do not tell the entire story. But let us not lose sight of the forest by looking at the trees, debating statistics when the policy of unreduced early pensions is the problem. If the policy of early retirement is a privilege paid-for mainly by taxpayers and yet not enjoyed by them, then where is the equity in continuing that policy? Indeed, if federal retirees retire later than assumed, why oppose change?

For the record, certain points should be made about the retirement age issue. First, the Bureau of Labor Statistics' Office of Employment and Unemployment Statistics does not collect data on average private sector retirement ages due to definitional problems (for example, is a rehired annuitant retired?), thus, there is no reliable private sector average retirement age data published by the government.

Secondly, let us beware of averages that mask significant data. The average age of retiring federal employees from 1973 to 1982 was 61.1 years, according to Table 15 on page 31 of the Congressional Research Service (CRS) report, "Background on the Civil Service Retirement System." What this Table does not state is that, according to OPM, about 39% of retiring federal employees retire within one year of attaining age 55 with at least 30 years of service.

Further, the 61.1 age refers only to optional retirement (those with age/service of 55/30, 60/20, and 62/5). It does not include retirement ages for disability, involuntary, deferred, mandatory, or special retirement situations (hazardous, Member of Congress, etc.).

The figure quoted by the Task Force is only for optional retirement. It represents 69.3% of the 85,000 retirees in 1982. As a matter of fact, 25% of the 1982 CSRS retirees left federal service at an average age of 52.

The question again, arises, how best do we correct the early retirement features of the civil service retirement system?

Both my FAIR proposal of the 98th Congress and S. 1527 are directed at bringing the early retirement features of a new federal system into closer conformity with private-sector practices.

Under my FAIR proposal, current employees as well as future employees would be able to retire under the same age-service provisions as under present law, but the amount of benefits based on service after the year of enactment would be subject to a reduction factor of two percent for each year under normal retirement age. The two percent rule would not reduce the amount of an employee's benefit which is accrued prior to the year of enactment. This change in the value of future benefits not yet earned is permissible under the law governing private pensions (ERISA) and responds to the arguments that changing the method of calculating benefits violates an implied contract between federal workers and their employer.

The Stevens/Roth plan also reduces an annuity for early retirement -- reducing benefits for retirement before age 62. Earlier this year the Reagan Administration also proposed a phase-in of reduced benefits for retirees between the ages of 55 and 65.

I am not suggesting that the reduction factor must be two percent as it was proposed in the FAIR legislation. I am suggesting that some reduction factor be considered. Social Security reduces benefits by 6-2/3% for every year under age 65. CRS reports, on page 42 of its December 1984 study for the House Post Office and Civil Service Committee, that a full actuarial reduction would reduce payments by six or seven percent per year. However, private pension plans often reduce employees' accrued pension benefits by about four or five percent a year if they retire early.

Employees should not be prevented from retiring early, but neither should they be encouraged to leave early by an excessively generous provision. I believe that a proposal to moderate early retirement costs will work to the benefit of our government and its employees.

Additional Components of a New Retirement System

As the Committee considers the Stevens/Roth plan and the development of a new civil service retirement system, there are a number of features of the system apart from COLAs and early retirement that need to be determined. Consistent with our policy, the Chamber believes that those features should approximate common features of private sector as much as possible.

In 1983, this Committee and the House Post Office and Civil Service Committee asked the U.S. General Accounting Office (GAO) to analyze information on prevailing features of retirement programs in the nonfederal-sector. In June 1984, GAO published its exhaustive study entitled Features of Nonfederal Retirement Programs.

The GAO report used the Department of Labor's Bureau of Labor Statistics' 1982 study entitled "Employee Benefits in Medium and Large Firms." This study involved 976 pension plans covering 17 million participants. GAO also used extensive surveys conducted by four private firms and by the National Association of State Retirement Plan Administrators.

The GAO report determined that retirement programs in the nonfederal-sector, where they exist, typically involve Social Security, a pension plan and a capital accumulation plan such as a thrift or deferred compensation plan. Within these broad components, specific features of private plans commonly are found. I would like to enumerate some of these items.

Normal Cost

The employer cost of the current CSRS is an unacceptably high percentage of the total federal payroll. CRS estimates the cost at 25% of pay. An independent study conducted for OPM found the cost to be 28% of payroll, as did the study by the President's "Private Sector Survey on Cost Control" (Grace Commission).

In the private sector, however, the employer costs are much less. The same study prepared for OPM, mentioned above, found that private pension costs were 18% of pay, while the Grace Commission placed the figure at 17%. These studies looked at the norms in medium and large companies that have pension plans. Other estimates, including the U.S. Chamber's annual Employee Benefits Survey and the U.S. Department of Commerce's Survey of Current Business, both of which look at the entire spectrum of business sizes across the economy, including those with and without pension plans, revealed the cost of retirement plans at between four and five percent of payroll.

The point is clear. By any measure, the cost of the present federal retirement system is inordinately high. The new system must seek to bring the normal cost of the retirement plan into accord with normal costs in the private-sector as a matter of fiscal responsibility toward the taxpayers who support the system, as a matter of equity between federal and nonfederal workers, and as a matter of honesty toward the federal employees who are relying upon the ability of the government to pay the benefits they are being promised.

Social Security Integration

The Social Security system replaces a higher proportion of earnings for people with lower average wages. The U.S. Chamber supports this "tilt" as a form of social insurance for lower-income earners. Because of this tilt, many pension plans are "integrated" with Social Security, in that a portion of the Social Security benefits is deducted from the benefits the pension plan would otherwise pay under its benefits formula. This deduction tends to equalize the proportional wage replacement among higher- and lower-paid workers when pension benefits and Social Security benefits are combined.

The GAO report found, among the surveys it used to compile its report, that between 64% and 96% of private-sector plans were integrated with Social Security. The degree to which the Social Security tilt is offset and the method by which it is done vary among different pension plans. However, the extensive data compiled by the studies which GAO analyzed clearly suggest that the integration of Social Security and pension benefits is the predominant practice in the private sector. To the extent that the new system is not integrated with Social Security, it is departing from the typical private-sector practice.

Employee Contributions

Federal employees covered by the current CSRS are required to contribute to their pension plan. According to GAO data, this is clearly contrary to the common practice in the private sector, where between 78% and 93% of the pension plans are fully paid by the employer.

Employer sponsorship, however, does not preclude the opportunity for voluntary employee contributions. As discussed above, capital accumulation plans are a typical feature of comprehensive retirement programs in the private sector. Whether it is in the form of a salary-reduction 401(k) plan, a thrift plan or other type of capital accumulation plan, the new system should encourage employees who can afford to do so to help save for their retirement. This will provide federal employees the same opportunity which many private-sector employees enjoy — to contribute toward their retirement income security — and will discourage the financial pressure on the federal government in determining its proper level of contributions.

The Stevens/Roth plan, by not requiring employee contributions to the defined benefit plan but by establishing a voluntary capital accumulation plan, resembles common features of private-sector retirement programs.

Vesting

In the CSRS, employees are vested after five years. The GAO report demonstrates that an overwhelming number of private-sector pension plans provide for "cliff" vesting after 10 years. A small percentage of plans provide for either "cliff" vesting after a period other than 10 years or graduated vesting. The Committee should be aware that the five year vesting feature of the defined benefit portion of the Stevens/Roth plan is not the prevalent practice in the private sector. In the absence of any evidence showing that vesting rules should differ for the private sector and the federal government, the new federal system should align itself more closely with the typical private practice.

CONCLUSION

Our Nation's private-sector pension system provides an ideal model for Congress to use in developing a pension system for newly hired federal employees. The mandatory inclusion of federal employees in the Social Security system places them in the same position as private-sector employees and adds further credence to the notion that a private-sector type of retirement program should be developed.

Several features of the Stevens/Roth plan resemble common features of private-sector retirement plans. The Chamber notes and appreciates that fact. In other respects, the Chamber notes that features of the proposal differ from common industry practices and encourages the Committee to bring the bill closer to conformity with private-sector practices.

Congress has before it a difficult challenge -- but also a unique opportunity -- to fashion a retirement system for newly hired workers. The challenge is to draft a balanced and reasonably-priced system. The opportunity, however, is to create an entirely new system for post-1983 hired federal employees and, by emulating common features of the private-sector system, avoid some of the troublesome aspects of the CSRS. I hope my comments will assist you in meeting this challenge and opportunity.

Senator **Gore**. We may have additional questions in writing to which I hope you would be willing to respond for the record, and I would like to thank you for your appearance here today.

Pursuant to the chairman's earlier statement, the committee will reconvene at 2 o'clock.

[Whereupon, at 12:55 p.m., the committee recessed to reconvene at 2 p.m. the same day.]

AFTERNOON SESSION

OPENING STATEMENT OF SENATOR EAGLETON

Senator **Eagleton**. Good afternoon, ladies and gentlemen. We continue our hearings.

I have an opening statement which I would have made this morning had I been here and not unavoidably detained in Missouri. So I will take the opportunity to read it—it is short—before we continue with our witnesses.

Today, we begin the second step in the process of establishing a new retirement program for Federal employees whose service with the Government, unlike that of their predecessors, will be covered by Social Security. The Congress set December 31 of this year as the deadline for providing a program for new employees who joined the Federal work force since January 1984. In the interest of sound personnel policy and in fairness to these employees, whose retirement benefits, you might say, have been in limbo, I believe it imperative that we meet this deadline.

The first step was concluded with the introduction by Senators Stevens and Roth of S. 1527, the proposed Civil Service Pension Reform Act of 1985. That bill represents the culmination of a considerable effort and significant contributions by many individuals and organizations, including the General Accounting Office, the Congressional Research Service, private sector experts, and both majority and minority staff members of this committee and its subcommittees.

I especially want to compliment Senator Stevens and his staff for the enormous work that they have put into this complicated and mind-boggling matter. In all of my 16 years in the Senate, this is perhaps the single most complicated matter with which I have dealt. Dealing with actuarial detail is not my personal cup of tea. I am too impatient. Senator Stevens, I might add, is not the pillar of patience. [Laughter.]

It is amazing that neither one of us hasn't exploded up to this point. If Senator Stevens hadn't persevered in this area, we wouldn't be having these hearings today. I thank him greatly, and I will have his staff member pass along my appreciation.

The proposal does not reflect in every aspect the views and desires of all those who contributed to its design. It will, I am sure, see some modifications as it goes through the legislative process.

However, I think the proposal does embody the overall intent to establish a system which, in combination with Social Security, provides for a fair level of retirement income security.

Once again, I would like to commend all of those who were involved for their excellent works.

The next step is a very important one. It is to receive testimony on the strengths and weaknesses of the proposed program, testimony which will serve to guide not only the members of this committee, but the Members of the Congress as a whole in their deliberations over the merits of the proposal.

I recognize that it is only natural to compare the provisions of any proposed new program to those of the existing civil service retirement system. However, in making such comparisons, particularly for the purpose of establishing a basis for suggesting changes in S. 1527, I caution that consideration must be given to the provisions of the total program; that is, the defined benefit plan, the thrift plan and Social Security, combined.

It is also important to keep in mind that one basic reason a new program must be established is because Federal employees now have Social Security coverage. The existing civil service retirement system evolved to provide retirement, disability and survivor benefits for employees who were not covered by Social Security.

Consequently, one cannot expect to find provisions in the proposed plan identical to those found in the current system.

What we should expect, and what I intend to aim for, is a retirement program that, in total, is equitable and affordable to both employees and to the Government.

Finally, I want to make a fundamental point: It is not my intent nor do I believe it is the intent of any member of this committee that the new retirement system we are devising for new Federal employees will serve in any way as a basis for altering the existing civil service retirement system.

We are not here engaged in any backdoor modifications of the existing system. We are here to devise a new system for new employees—nothing more and nothing less.

Now we will continue with our witnesses, and our first witness for this afternoon's session is Mr. George Vest, Director General of the Foreign Service and Director of Personnel for the Department of State.

TESTIMONY OF GEORGE S. VEST, DIRECTOR GENERAL OF THE FOREIGN SERVICE AND DIRECTOR OF PERSONNEL, DEPARTMENT OF STATE, ACCOMPANIED BY TORREY WHITMAN AND ROBERT HULL, POLICY COORDINATION STAFF

Senator STEVENS. Mr. Vest, we are delighted to have you with us.

Mr. VEST. Thank you very much, Mr. Chairman. I have with me Mr. Robert Hull and Mr. Torrey Whitman for assistance.

I would like to refer to my statement, not read the whole thing in the interest of time, but bring up what I consider to be the key points in it.

The Secretary has asked me to represent him at these hearings on the design of a retirement system for Federal employees covered by Social Security, and we appreciate this opportunity very much. Retirement provisions are essential to any personnel system and are especially so for the Department of State, which has employees under two statutorily distinct retirement systems: civil service and Foreign Service.

We believe that S. 1527, the Stevens-Roth bill, is a constructive effort to make the new Federal retirement system both fair and equitable to participants and financially sound, as well. The three-tiered structure of benefits should accommodate the retirement planning goals of a wide variety of Federal employees with different career patterns.

We understand that the bill's provisions for a thrift plan with employer matching of employee contributions may need to be revised in the light of the administration's recent proposal to repeal section 401(k) on which they are based. Nevertheless, we believe that thrift plans are a very attractive feature of the many private sector retirement plans, and we trust that some form of thrift plan will be retained as part of this retirement package.

Our overall impression of this bill is thus very positive. In fact, my principal reason for being here today is to request that the committee consider including Foreign Service personnel under Stevens-Roth.

The basic framework of the bill will be beneficial to both Foreign Service and civil service employees of the Department of State. Since we have appreciable numbers of employees who convert from civil service to the Foreign Service in midcareer and vice versa, the Department of State has a management interest in seeing a basically similar retirement structure for each personnel system.

In looking at the Stevens-Roth bill, we do believe that the Foreign Service should clearly be regarded as a special category of employment, as are air traffic controllers, firefighters, and law enforcement officers.

I would note that the Foreign Service retirement system, like those of the other special groups, allows optional retirement earlier and with fewer years of service than the existing civil service system. In our case, Foreign Service employees may retire at age 50 with 20 or more years service.

There are two overriding and related reasons for these existing special Foreign Service provisions. First, we need to retire mandatorially, as a result of the existence of the Foreign Service Act of 1980, the less competitive, as determined by management, to ensure that the highest standard of performance in foreign policy analysis and overseas representation is guaranteed. Foreign Service personnel today are subjected to increasingly vigorous competition with their peers in the course of their careers, with the result that some employees are retired involuntarily each year for failure to be promoted to the next higher grade or class within a specific time period. This time-in-class limitation sets up an up-or-out promotion system, and it requires officers who are performing competently at their current grade level, but who are not sufficiently competitive to be advanced or promoted to higher levels, to be retired.

Second, we must provide through early retirement an exit, other than for substandard performance, for those who are no longer able to serve abroad for such reasons as health. The Foreign Service is an arduous and increasingly dangerous life; those who, after a long and valued career, cannot continue to meet those challenges and cannot continue, for example, to get medical clearances, should be able to retire voluntarily without being selected out for substandard performance.

Our work force analyses indicate that an appreciable number of those potentially subject to retirement for time-in-class, both now and into the future, will be between the ages of 50 and 55. The Stevens-Roth special category rules would allow employees who have this approximate time to receive an immediate annuity, but the income replacement at time of separation would be quite small compared to what we would have in our present Foreign Service situation: An involuntary retiree aged 50 with 25 years of service would receive an annuity of about 18 percent of his salary under Stevens-Roth, as opposed to about 50 percent under the current system.

I do not believe that we could continue to operate involuntary retirement for time-in-class to promote an up-or-out system under such conditions. Frankly speaking, such a small benefit would be perceived harsh and inequitable, would be uninteresting increasingly to young applicants, and would invite distortion in the management area.

It is necessary, in our view, then, to give some special attention to employees who retire before the age of 50. We believe that the Foreign Service should refine its existing retirement threshold, allowing retirement without an annuity reduction at age 50 with 20 years service. This age and service requirement is not inconsistent, I am told, with that which has been proposed by OPM Director Horner for other special categories of employees.

The committee should also be aware that the Foreign Service system differs from the civil service system in several other respects, such as its treatment of the rights of former spouses to annuities, pay provisions for reemployed annuitants, and certain other benefits for foreign national employees, of which we have over 9,000 worldwide. Each of these existing differences would need to be addressed in the development of a final bill.

I would draw your attention to one other feature of the Foreign Service retirement system: the Department of State currently administers the system, rather than the Office of Personnel Management, and a separate retirement trust fund is maintained for the Foreign Service by the Department of Treasury. Presumably, the separate fund will continue in existence for those pre-1984 Foreign Service employees who do not elect to transfer into the new system, and the Department will continue to administer the Foreign Service system at least for those employees. Such an arrangement will need to be made to ensure that the current fund continues to be sufficient to pay benefits.

I have dwelt at some length on special treatments needed to make the Stevens-Roth retirement structure mesh with the Foreign Service personnel structure. I felt it was necessary, but let me emphasize that I believe the effort was well worthwhile. We believe this bill will benefit the Government, the employees, and the taxpayers of this country, and we do support it. Thank you very much, Mr. Chairman.

Senator EAGLETON. Thank you, Mr. Vest.

You maintain that one of the two major reasons why special retirement benefits must be provided for Foreign Service personnel is because they are subject to being selected out, either because of poor performance or time in grade, or they just didn't get promoted.

Are all the employees covered by the Foreign Service retirement system subject to this selection out mechanism?

Mr. VEST. All the employees in the Foreign Service portion of the State Department activity are covered by the selection out system.

Senator EAGLETON. Which includes professional and clerical, as well?

Mr. VEST. Professional and clerical, all but secretaries.

Senator EAGLETON. Not secretaries.

Mr. VEST. But all remaining categories in the Foreign Service system are covered by this system.

Senator EAGLETON. You are emphasizing the Foreign Service system. Now, AID does not have the selection out process, is that correct?

Mr. VEST. AID has its own system, and it does have a selection out portion. I'm not competent to talk about the details, I regret, of their system.

Senator EAGLETON. OK. What about agriculture representatives serving abroad? Do they have selection out?

Mr. VEST. I can't speak for the other agencies.

Senator EAGLETON. We will get the answers.

Mr. VEST. I can only make the distinction between our civil service component. I should, if I could put it in one sentence. The Foreign Service clientele in our group, we have over 9,000 who are in the Foreign Service, of which approximately two-thirds serve overseas. We have approximately 4,000 who are in the State Department in the civil service, and we have over 9,000 who are Foreign Service nationals, alien local employees who help to service and support our positions in our embassies.

Senator EAGLETON. Let me get those numbers. There are 9,000.

Mr. VEST. Over 9,000 in the Foreign Service.

Senator EAGLETON. In the Foreign Service. Is that both overseas and here in the Department?

Mr. VEST. That is right, with approximately two-thirds of them, at any given time, overseas.

Senator EAGLETON. All right. Does that exclude secretaries?

Mr. VEST. That includes the secretaries. I am assured that AID, CIA, Foreign Agriculture Service and the Foreign Commercial Service all have selection out along the same basis.

Senator EAGLETON. We have some old figures here, and we are going to ask you to get us some new ones, but we have figures back into the midseventies. For instance, in 1974, a total of 29 people were selected out, according to our figures; in 1975, 6; in 1976, 8; in 1977, 11; and then our figures cease.

If those figures are right, the figures from 1974, 1975, 1976, and 1977, we are dealing with rather minescule numbers. If you eliminate the 29 year, you are dealing with a dozen or less per year out of 9,000. Maybe it was a smaller number back then. Say it was 7,000.

For instance, do you, have with you or currently available selected out numbers for the years from 1978 onwards?

Mr. VEST. I don't, but I have last year's, sir.

Senator EAGLETON. Give me last year's.

Mr. VEST. I will have the other. Last year, the Department of State separated 66 Foreign Service employees for failure to be promoted to the next higher level within the specified time period.

Senator EAGLETON. That would be about seven-tenths of 1 percent.

Mr. VEST. Let us say less than 1 percent, but they constitute a significant portion of all retirements, and that 66 is a very significant figure in 1 year because it is on its way up. You are quite right to point to periods 29, 6, 8, 11 and so on.

That was before the act of 1980. With the act of 1980, we instituted an up-or-out system, with the result that we now have, to the dismay of a lot of people, a very heavily increased percentage, and to move from 11 to 66 shows what has happened.

Senator EAGLETON. All right. Here is what I would like to have you do for us for the record, if you could have one of your staff people come up after your testimony. The way we have this broken down year by year is, we have maximum time-in-class. For instance, going back to 1974, there were nine people who were selected out in that line; in the substandard performance line, 20, for a total of 29. We have this, as we say, year-by-year up until 1977. For the record, tell us whether what we have is accurate and then update for us through calendar year 1984, if you will.

Mr. VEST. Certainly, sir. If I may reiterate once more, Mr. Chairman, that with the arrival of the act of 1980, we are doing something else very different in the management of our Foreign Service. The act of 1980 insisted that we should implement an up-or-out system, and this created a totally different way of managing our Foreign Service, and we are doing it.

Senator EAGLETON. You maintain that the new program should retain the current retirement threshold for Foreign Service employees at age 50 with 20 years of service. Is that your initiative?

Mr. VEST. Yes.

Senator EAGLETON. You also pointed out that this is consistent with what has been proposed by the Director of OPM. My question is, do you have any evidence to support that Foreign Service personnel, on the average, cannot perform their jobs after age 50 or after completing 20 years of service?

The reason I ask that is that a GAO report, a rather recent one dated January 7, 1985, shows that such personnel, on average, retire at about the age of 56 after 27 years of service.

Mr. VEST. We have a very high percentage of our personnel who do retire at about the age of 56. I think the records, again, will show that that has been a rather consistent figure often.

But what the new act mandated us to do was to implement an up-or-out system, which means, the people who authored the act designed it so explicitly that we would have people retiring more nearly at the level of a Navy captain and a fewer number would go on to be the equivalent, in our service, of the admirals.

That means that we have reduced very heavily a number of people who get promoted to the senior Foreign Service. We have been accused throughout the years of having a large number of senior officers unemployed called walkers. We have set up to redress that balance. That does mean that you set up a system, which is an adequate one, but which does have them retire at that time when they can no longer compete.

The object is not to get someone who can do the job, but to get what we consider the best and retain the best for the senior positions. That is why we have this consequence. That is why we aim at 50 and hope to keep 50.

Senator EAGLETON. I know many Senators who have visited extensively abroad. I always touch base with the U.S. Embassy, et cetera, and I can say almost without exception that I have a uniformly high opinion of the good quality and caliber of people that serve in the U.S. Foreign Service. I, for one—and I think I speak for Senator Stevens—want that same quality to continue and do not want that quality to be damaged by a neglectful intention to cause a problem in the retirement benefits.

In my judgment, after talking with these folks, and I talked with them specifically about retirement, not on every occasion, but some, I think even a valid argument, rather than separating out, although the figures are preceding since the 1980 act, is burn out. I think the pressures of Foreign Service, serving overseas—and bear in mind, not everybody gets to serve in London—there are an awful lot of places where there is pressure on them, and the pressures of service are enormous. I think there is a burnout factor. I don't mean that everybody in the Foreign Service at age 50 is over and done with. I suspect you are getting close to 50 yourself.

Mr. VEST. Thank you for the compliment. [Laughter.]

Senator EAGLETON. I think Mr. Shultz has a few days to go. Not everyone is over and done with at 50, but I think the pressures, the strains, are very, very significant, and I think we have to take that into account. I just think they are there. They are inherent with the job.

Mr. VEST. Senator, if I may say, I deeply appreciate what you have said, because in my remarks I referred to a voluntary group who, for one reason or another, really are not in a position to go on serving overseas. In many cases, they fall into exactly the category you are talking about, and they have given terrific service. At that point, they really need to be given a chance to change.

Senator EAGLETON. Yes.

You said in your testimony that under the current system a Foreign Service officer with 25 years at age 50, if I heard you correctly, would retire with 50 percent of pay. Is that right?

Mr. VEST. Yes, sir.

Senator EAGLETON. By the way, is that a high 3 or high what?

Mr. VEST. It is a high 3 at the present time.

Senator EAGLETON. High 3, all right. Then you said under Stevens-Roth, it would be 18 percent.

Mr. VEST. Yes, sir.

Senator EAGLETON. However, that did not take into account that they eventually will get Social Security. That will be added, right?

Mr. VEST. Yes, sir.

Senator EAGLETON. It also did not take into account what that individual might have put into the thrift plan.

Mr. VEST. Yes.

Senator EAGLETON. That is, speculating amounts that individuals might have put in.

Mr. Vest. Yes.

Senator Eagleton. They amount to a little or some. How are we going to compare all of this, then, from my simple head? You have got to factor in Social Security. I guess you have heard that. How are we going to compare this 18 percent plus Social Security plus thrift vis-a-vis 50 percent?

Mr. Vest. I don't have a comparative answer for you at the present time, sir. We are working on that, but I couldn't give it to you now.

Senator Eagleton. All right. If your actuaries and numbers guys over there want to give us something to rough up a comparison, it will be a difficult question toanswer, but I would like to have it.

How much, in your opinion, are retirement and retirement benefits a factor in recruiting or in attracting a young Foreign Service applicant?

Mr. Vest. That is a very subjective question, Senator. I am going to make a guess at it.

Senator Eagleton. Think back to your first days. When did you start? How old were you when you went in?

Mr. Vest. I was 28. I was a GLA, and it was 1946 when I took the exam. I think the situation is honestly not so different today. I don't meet every new class of young Foreign Service officers that come in. I don't think retirement is a major factor. That is not what draws and makes people take the plunge into this very challenging Foreign Service life.

It wasn't the case when I joined it in 1947, and I don't think it is today. In all candor, I think——

Senator Eagleton. How big a factor is it in retention? Suppose the guy is in 5 years, 8 years.

Mr. Vest. This is what I was going to get to. Looking at my experience with a wide range of Foreign Service officers since 1947, I think as a person goes on in the Foreign Service, they are married, or they get married; they have children; they begin to think about costs, education, all the rest. And they begin to think about it rather more after they get into the career pattern. At that point, one of the great factors in keeping our best people is an attractive retirement system.

Without that, there is a heavy impetus to say, "I have got two kids to educate. It is costing $11,000 or more a year. It is going to get worse. I have got a chance to go off now, right at this point, to a business, and maybe I better go." Attrition, I think, would be a factor. The attraction—and it is an attraction, the retirement system that we have had—makes it possible for somebody, when he and his wife sit down and argue out, "How do we look ahead," to say, OK, I have got a reasonably even projection here I can live with, and it will even out over the years; I will stick with it, because I really prefer to stick with it. I think that is the way our Foreign Service works, today as earlier.

Senator Eagleton. I suspect you are right. I talked, as I say, to enough of these folks, and I suspect your analysis is pretty close to the mark.

Now my final question: The General Accounting Office has issued reports and has also testified that a government is ill-served by maintaining totally different retirement programs and trust funds. Would you accept an alternative to your desire to have separate funds by permitting a separate accounting within the civil service trust fund but allowing you to administer your part of the program?

Mr. **Vest**. If I may, I would like to ask Mr. Whitman to comment on that.

Senator **Eagleton**. Yes, sure.

Mr. **Whitman**. Senator, I think that from the Department of State Foreign Service's point of view, we feel that in the administration of our existing retirement system, we do a very good job. We have a small shop, but they service our employees very well. They get the benefits out very rapidly. We provide a lot of personal service to our employees, and I think particularly when our employees are shuttled around the world as much as they are, being able to provide that personal face-to-face service is very important.

It is that portion of the administration of a retirement system that we wish very much to preserve. I think the question of where the funds reside and how they are kept is very secondary to us.

So in answer to your question, I believe yes, something that would allow us to make the administrative determination could be the key feature that we would like to keep.

Mr. **Vest**. Could I make, Senator, just one point?

Senator **Eagleton**. Yes.

Mr. **Vest**. When you travel around the world two-thirds of your career, you become extremely attached to those few people and those few offices that represent home base and who know who you are. That is why this whole system, as Mr. Whitman has described it, is so important.

Senator **Eagleton**. Fine. Thank you, Mr. Vest. Thank you, gentlemen. I appreciate it.

[Mr. Vest's prepared statement and responses to written questions from Senator Eagleton follow:]

STATEMENT OF
GEORGE S. VEST, DIRECTOR GENERAL OF THE FOREIGN SERVICE AND DIRECTOR OF PERSONNEL, DEPARTMENT OF STATE
BEFORE THE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE
ON S. 1527, THE CIVIL SERVICE PENSION REFORM ACT,
SEPTEMBER 9, 1985

The Secretary of State has asked me to represent him at these hearings on the design of a retirement system for Federal employees covered by Social Security. We appreciate this opportunity very much. Retirement provisions are essential to any personnel system, and are especially so for the Department of State which has employees under two statutorily distinct retirement systems--Civil Service and Foreign Service.

We believe that S. 1527, the Stevens-Roth bill, is a constructive effort to make the new Federal retirement system both fair and equitable to participants and financially sound as well. The three-tiered structure of benefits should accommodate the retirement planning goals of a wide variety of

Federal employees with different career patterns. We understand that the bill's provisions for a thrift plan with employer matching of employee contributions will need to be revised in light of the administration's recent proposal to repeal section 401(k) on which they are based. Nevertheless, we believe that thrift plans are attractive features of many private sector retirement plans. We trust that some form of thrift plan will be retained as part of the retirement package. It is our belief that offering access to a thrift plan may make Federal employees more mobile, and generally encourage more movement back and forth between private and public sector employment. Such a development would be beneficial to all concerned. Moreover, the thrift plan could give a boost to capital formation and thereby aid in maintaining and expanding the national economy.

Our overall impression of the bill is thus very positive. In fact, my principal reason for being here today is to request that this Committee consider including Foreign Service personnel under Stevens-Roth.

The basic framework of the bill will be beneficial to both Foreign Service and Civil Service employees of the Department of State. Since we have appreciable numbers of employees who convert from the Civil Service to the Foreign Service in mid-career, and vice-versa, the Department of State has a management interest in seeing a similar retirement structure for each personnel system. Employees currently can transfer either to or from the Foreign Service with no major effect on their entitlement to retirement benefits; we would not be well served by a Foreign Service system structured significantly differently from the general Civil Service system.

In looking at the Stevens-Roth bill, we believe that the Foreign Service clearly should be regarded as a "special category" of employment, as are air traffic controllers, firefighters, and law enforcement officers. I would note that the Foreign Service retirement system, like those of the other special groups, allows optional retirement earlier and with fewer years of service than the existing Civil Service system. In our case, Foreign Service employees may retire at age 50 with 20 or more years of service.

There are two overriding and related reasons for these existing Foreign Service provisions. First, we need to retire mandatorily the less competitive, as determined by management, to ensure that the highest standard of performance in foreign policy analysis and overseas representation is guaranteed. Foreign Service personnel are subjected to increasingly rigorous competition with their peers in the course of their careers, with the result that some employees are retired involuntarily each year, for failure to be promoted to the next higher grade or class within a specified time period. This "time-in-class" limitation requires officers who are performing competently at their current grade level, but who are not sufficiently competitive to advance to higher levels to be retired.

Second, we must provide through early retirement an exit, other than for substandard performance, for those who are no longer able to serve abroad. The Foreign Service is an arduous and dangerous life; those who, after a long and valued career, cannot continue to meet those challenges should be able to retire voluntarily, without being selected out for substandard performance.

Our workforce analyses indicate that an appreciable number of those potentially subject to retirement for "time-in-class", both now and into the future, will be between the ages of 50 and 55. These employees typically would have about 25 years of service. The Stevens-Roth special category rules would allow such employees to receive an immediate annuity, but the income replacement at time of separation would be quite small compared to the current situation: an involuntary retiree aged 50 with

25 years service would receive an annuity of about 18 percent of his salary under Stevens-Roth, as opposed to about 50 percent under the current system.

I do not believe that we could continue to operate involuntary retirement for time-in-class under such conditions. Frankly speaking, such a small benefit would be perceived as harsh and inequitable, and managers and supervisors would be likely to change their personnel management decisions in order to shield employees from selection out, thereby defeating the basic purpose of the selection out mechanism.

It is necessary in our view, then, to give some special attention to employees who retire before the age of 55. We believe that the Foreign Service should retain its existing retirement threshold, allowing retirement without annuity reduction at age 50 with 20 years service. This age and service requirement is not inconsistent with that which has been proposed by OPM Director Horner for other special categories of employees.

It might also be desirable to consider allowing agencies to pay the supplemental payment in lieu of Social Security to all special category employees from the time of retirement, rather than solely from age 55 to age 62. I believe that the provision of one or more of these income supplements would allow the Foreign Service to harmonize the new retirement system with its existing selection-out system. I hope that we can work together on these special points of concern.

The Committee should also be aware that the Foreign Service system differs from the Civil Service system in several other respects, such as its treatment of the rights of former spouses to annuities, pay provisions for reemployed annuitants, and certain benefits for foreign national employees. Each of these existing differences would need to be addressed in development of a final bill.

I would draw your attention to one other feature of the Foreign Service Retirement System: the Department of State currently administers the system, rather than the Office of Personnel Management, and a separate retirement trust fund is maintained for the Foreign Service by the Department of the Treasury. Presumably the separate fund will continue in existence for those pre-1984 Foreign Service employees who do not elect to transfer into the new system, and the Department will continue to administer the Foreign Service system at least for those employees. Some arrangement will need to be made to insure that the current fund continues to be sufficient to pay for benefits.

I have dwelt at some length on special treatments needed to make the Stevens-Roth retirement structure mesh with the Foreign Service personnel structure. But let me emphasize that I believe the effort to be well worthwhile. The world has changed immeasurably since Federal retirement legislation was put in place; it is now time to bring our treatment of retirement in line with those changes in the world. We must recognize that our young employees of today, those after all who have the most to gain or lose from this legislation, have a different outlook, a different set of assumptions about career mobility and change than the employees of two generations ago for whom the existing systems were designed. The bill under consideration by this committee does recognize that important fact. We believe that the bill will benefit the government, the employees, and the taxpayers of this country and we support it.

Question for the Record
on
S. 1527, The Civil Service Pension Reform Act
submitted by
Senator Eagleton

Question: In his testimony, Director General Vest urged that early retirement without penalty at age 50 be retained for Foreign Service personnel. He cited a hypothetical example indicating that an FSO retired for time-in-class at age 50 with 25 years service would receive a pension equal to 50 percent of his final salary under the existing law, and stated that under Stevens-Roth that amount would fall to 18 percent. Wouldn't that hypothetical retiree actually receive more than 18 percent of his final salary, if the annuity supplement in lieu of Social Security and distributions from his thrift plan are taken into account?

Answer: Yes, if the employee had a thrift plan and if the Social Security supplement were payable from moment of retirement. To begin with, the 18 percent figure assumes that a 25 percent reduction factor would be applied to the employee's defined benefit annuity, due to his being five years younger than the age 55 threshold for a "special category" employee under Stevens-Roth. If there were no penalty applied to annuities of involuntary retirees, our hypothetical employee would receive his full 25 percent annuity. In addition, the age 50 employee might add anywhere from 7.5 to 12.5 percent to his income from thrift plan distributions, i.e, about 2.5 percent of income for each 1 percent contributed and matched over the 25 years of employment. If it were payable at age 50, a Social Security supplement would replace about 10 to 12 percent of income for our hypothetical employee, assuming a normal salary curve for an FSO retired at the Class 1 level. Altogether, then, income replacement would range from 25.5 to 49.5 percent at age 50. The lowest figure would apply if the annuity were reduced, if no Social Security supplement were payable at age 50, and if the employee had contributed to his thrift plan at the rate of 3 percent per year. The highest figure assumes no annuity penalty, an immediately available Social Security supplement, and a 5 percent thrift plan contribution rate.

We believe this example underlines the significance of waiving early retirement penalties for involuntary retirees and of making the supplement in lieu of Social Security payable from the time of retirement, rather than from age 55. With those provisions, total income replacement for the involuntary retiree is quite adequate; without them, we believe that retirement benefits for involuntary retirees would be perceived by managers as unequitably small. Such a perception would result in management decisions about assignment or evaluation of personnel being unduly influenced by attempts to avert the possibility of an employee's being retired for time-in-class, to the detriment of the organization as a whole.

Question for the Record
on
S. 1527, the Civil Service Pension Reform Act,
submitted by
Senator Eagleton

Question: In your testimony, you stated that the Foreign Service personnel system is an "up or out" system, and that significant numbers of Foreign Service personnel are separated or selected out for "time-in-class" each year. Can you explain how the selection out mechanism works? How many people have been separated involuntarily in each of the past ten years?

Answer: Selection out of the Foreign Service is mandated by the Foreign Service Act of 1980 (reaffirming the Foreign Service Act of 1946), which authorizes the Secretary of State to regulate the maximum time in which a member of the Foreign Service may remain in class without being promoted. The Secretary is also required to set the standard of performance which any member must meet to remain in the Foreign Service. (Sections 607 and 608 of the Act.)

Substandard performance: Selection out for failure to meet performance standards is a three step process. First, members of the Foreign Service are ranked annually by Selection Boards, consisting of their peers as well as public members. These Boards designate officers whose performance as compared to their peers appears to be substandard. Employees so designated are reviewed by a Performance Standard Board which may identify the employee as substandard, and which justifies such identifications in writing.

Officers so identified are involuntarily retired, unless such action is reversed through an appeal. Officers may appeal the determination of selection out through the grievance procedure, or by appealing to a Special Review Board, composed of three career members senior in class to the appelant. These remedies are exclusive; election of one precludes resort to the other.

The SRB reviews all information considered by the PSB; affords the appellant a hearing at which he may be represented by counsel, present witnesses, interrogatories or other relevant information; and decides whether to uphold or reverse the selection out determination of the PSB.

In the 1970's, employees ranked in the lowest percentiles of their class were automatically considered for selection out. The percentages typically varied between 7 and 10 percent of the class, but in most years very few employees were actually separated involuntarily. Since 1980, selection boards have not been required to designate any specific percentage of employees for selection out consideration.

Time-in-class: Any Foreign Service Officer below the rank of Career Ambassador is subject to involuntary separation for failure to be promoted or receive a Limited Career Extension (LCE's apply only to the Senior Foreign Service) within a specified time period. Prior to 1976, the time in class regulations limited the maximum time at the then highest classes of the service, Class 1 and Class 2, to 12 and 10 years respectively. Classes 3, 4, and 5 were subjected to a 20 year multi-class rule, with no more than 15 years in any one class. In 1976, the Class 1 and 2 limits were changed to 22 years cumulative in Classes 1 and 2, but not more than 10 years in Class 2. In 1978, time in multi class was extended to 22 years for mid-level Classes.

Beginning in 1981, the time-in-class limits for the Senior Foreign Service which had replaced Classes 1 and 2 were changed to: Counselor(the old Class 2 equivalent) - 7 years; Minister-Counselor(the old Class 1 equivalent) - 5 years, and Career Minister(which previously had no time-in-class) - 4 years. For these senior classes, there is the possibility of receiving a Limited Career Extension, which effectively extends the time-in-class limit by 3 years.

Numbers of separations: As can be seen, three major influences have acted on involuntary separations in the past 10 years. Institution of more elaborate due process reviews of selection out for substandard performance has reduced the number of involuntary separations for substandard performance. Imposition of the time in multi class rule for mid-level officers(formerly Classes 3, 4, and 5, now Classes 1, 2, and 3) has begun to increase retirements for time-in-class. New, shorter time-in-class limits for senior officers brought into being by the 1980 Act has also increased time-in-class retirements in the senior ranks. Overall, involuntary retirement totals for the period 1974-1984 are as follows: 1974 - 29; 1975 - 6; 1976 - 10; 1977 - 16; 1978 - 21; 1979 - 23; 1980 - 21; 1981 - 25; 1982 - 22; 1983 - 28; 1984 - 66.

The large increase in 1984 marks the first real impact of shorter time-in-class rules for senior employees. Workforce planning projections for the period 1985-2000 indicate that on average, about 60 employees per year will be involuntarily retired through the operations of the selection out system.

Senator EAGLETON. Our next witness is Mr. Fossel, senior vice president and director, Alliance Capital Management Corp., New York.

You may proceed, Mr. Fossel.

TESTIMONY OF JON S. FOSSEL, SENIOR VICE PRESIDENT AND DIRECTOR, ALLIANCE CAPITAL MANAGEMENT CORP.

Mr. FOSSEL. Thank you, Senator. Let me introduce myself a little more thoroughly at the outset. I am, as you said, senior vice president and director of Alliance Capital Management, one of the world's largest investment management organizations. Presently, we manage slightly in excess of $23 billion of other people's money, the vast majority of which is for corporate pension plans and for State and local government retirement systems. Our clients include 31 of Fortune magazine's top 100 companies and approximately 50 government retirement systems across this country, all the way from Hawaii to the State of Maine and from the State of Minnesota to the State of Florida.

Senator EAGLETON. How many States?

Mr. FOSSEL. Twenty six.

Senator EAGLETON. How about Missouri?

Mr. FOSSEL. No, sir.

Senator EAGLETON. Alaska?

Mr. FOSSEL. Yes, sir.

Senator EAGLETON. They have more money than we do. [Laughter.] Go ahead.

Mr. FOSSEL. Here in the Washington area, the District of Columbia Teachers, Police, Firefighters, and Judges Retirement Board is one of our clients, as is the State of Maryland.

In addition to having spent 21 years in the investment business, I took 4 years off and served in the New York State Legislature, where I served on the Ways and Means Committee and on the Government Operations Committee, and for the last 2 years, was the ranking member of Government Operations. Therefore, my judgment from not only on my professional career side, but also on my political career, however brief it was, side with the fiscal budget and retirement issues that you are dealing with was quite considerable. I think it gave me a far better understanding of some of the pros and cons of different steps that could be taken.

I might also add, the State of New York is one of our clients.

In the next 10 or 15 minutes, what I would like to do is share with you my thoughts on the investment implications of the proposed changes in the Federal retirement system and specifically, the establishment of the thrift savings plan. I should point out that the testimony I am about to give does not necessarily represent the views of my firm, but I think it does represent a fairly broad consensus of professional investment thinking today.

I would like first to look at the investment implications from two very different perspectives. First, what are the implications for each of the proposed act's major elements?

Then second, what are the ramifications of some of those acts on the major interested parties.

The private sector investment certainly, in the proposed thrift plan, is something very new to the Federal Government. I would like to take a considerable amount of time addressing myself to whether or not the thrift plan or savings plan, or whatever name it ends up with, is a sensible approach or rather, does the approach that has been used for the Federal system over the years of investing in special Treasury issues make more sense.

I think, first, the question should not be whether or not the private sector investments ought to be made or not made versus public sector investments, but rather, what investment approach is best suited to providing appropriate retirement benefits or a savings plan to Federal retirees at the least cost to the employer and the current participants and at an acceptable level of risk to future and existing participants, as well.

In my opinion, the answer to that question is that most investments in a proper mix for a retirement system as large and with as long a term a perspective as the Federal Government's—or, for that matter, almost any other retirement system—make sense, the mix of investments depending on the change and mix of the work force, their age; depending on what actuarial assumptions one wants to use; depending on the nature of the plan or the combination of plans available; depending on the preference of the employee; and then depending also on changing economic and investment directions and the prospective real returns and risks associated with each alternative.

The chart [1] in my testimony which I hope you have copies of immediately following page 5, is entitled slide I and look likes this.

Senator EAGLETON. I have it.

Mr. FOSSEL. It shows through 1983 the changing mix of different investment vehicles used by pension plans administered by State and local government retirement systems in this country. The source was the Federal Reserve Board, and you will note in there have been substantial secular changes in the mix of investment vehicles. You will note that the light gray-shaded area, State and local government bonds have declined substantially, for maybe all the obvious reasons of lack of tax deductibility, or where it makes no difference in the case of a tax-free pension plan.

At the same time, you will note that corporate bonds and corporate stocks, corporate equities, the white area, have grown very substantially as a share of those assets.

Some of those trends undoubtedly are cyclical, as investment managers tailor the portfolio as they see changing trends in the financial markets. But many of them are secular.

I might note parenthetically that the total assets in those plans as of the end of 1983 was in excess of $300 billion. Those are only State and local government retirement plans.

A similar chart, if I had one, for corporate pension plans would show a very different asset mix but would show very similar long-term trends. The difference in the asset mix primarily would be that it would be a much higher percentage in corporate stocks and a lower percentage in other fixed-income vehicles.

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[1] Charts referred to appear in Mr. Fossel's prepared statement.

Senator EAGLETON. Give me a guess what would be corporate stocks in the private sector; 28.1, is it?

Mr. FOSSEL. Probably roughly twice that, something in excess of 50 percent would be in stocks.

That is a development that has occurred over a period of years as professional investment managers have become more familiar with the alternative risk and reward characteristics, which we will talk about in a minute.

Senator EAGLETON. What do you guys say when we have the next crash?

Mr. FOSSEL. The crystal ball is never perfectly clear, Senator Eagleton. All we can do is go by past trends, which we will come to in a minute, and make some prognostications of the future, for which we get paid. By definition, in my mind, I think most professionals in the pension and investment management business believe a retirement system should have a very long-term perspective. The employees and/or the employers make contributions generally over a very long number of years, and if they don't, those contributions are typically invested, anyway, for a very long number of years.

The beneficiaries usually receive benefits for many, many years, hopefully a very long number of years. Therefore, in order to improve benefits and/or to reduce costs through the attainment of returns, the assumption of some shorter term volatility, which is traditionally called risk in our business, is not only appropriate, but it is also entirely prudent.

If you will turn to the graph [1] past page 6, and I apologize for not actually having slides. If the Eastern shuttle hadn't stayed on the ground for 2 hours, I would have had the screen up and the slides up, but note the graph following page 6, which looks like that.

Senator EAGLETON. Thank you.

Mr. FOSSEL. This illustrates the compounding returns that have been achieved by the four major investment assets over the past 59½ years. This is the work that is best known in the industry as the work of Professor Ibbotsen from the University of Chicago and Professor Sinquefeld. What they have done is taken all the investments in those categories and tracked them back from 1926 to the present.

What it shows is pretty clear. That was a period that we could say was an abnormal period. All periods are abnormal periods. It had two declared wars, it had one depression, more than a dozen recessions, an industry crisis, one Presidential assassination and a near miss, inflation, deflation, stagflation, and now disinflation, in other words, hardly a placid and predictable period.

Yet as you can see, the most risky asset, common stocks, achieved the highest return by three times as much per year in nominal terms as did Treasury bills, ostensibly a risk-free investment, which is also virtually a return-free investment in real terms.

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[1] The charts may be found in Mr. Fossel's prepared statement.

That is to say that common stocks as measured by the Standard and Poors 500 returned, over that 59½-year period, 9.7 percent per year, and long-term corporate bonds, 4.6; long-term Government bonds, 3.9; Treasury bills, 3.4, and all that was against inflation that averaged 3.1 percent over that period.

Senator EAGLETON. What would the professor tell us that this period had been from 1926 to 1936?

Mr. FOSSEL. We will come to that period shortly. Your questions are very good, and I think I have anticipated at least that one.

The next chart, which is just following page 7, entitled slide No. III, shows the cumulative effect and is particularly dramatic. Obviously, the longer term that investment has been in place, of a dollar invested at the end of 1925 in each one of those investment alternatives, you would see that a dollar left in and compounding and reinvesting dividends today, on June 30 of this year, would have been worth $248.25.

The same dollar invested in long-term corporate bonds would be worth $14.51; $9.68 had it been invested in long-term Government bonds, and $7.20 if it had been invested in Treasury bills.

Obviously, the impact of high returns for the employer and the employee over a long period of time is particularly dramatic, especially when you realize the value of your dollar in that period has gone down by 85 cents. That is, the dollar is worth 15 cents today stated in 1925 terms.

The graph, however, shows something else, and this is the point you just began to raise. That is, how much more volatile the short term, shorter term anyway, return from stocks has been when compared to the less risky or less volatile investment alternatives.

Over this period, the annual return for stocks ranged froma plus 54 percent in 1933—surprisingly, I think to a lot of us, that was the best year ever—and then to a minus 43 percent in 1931. Long-term Government bond returns ranged from a plus 30 percent in 1932 to a minus 1 percent in 1946. Treasury bill returns, while much lower, also have shown by far and away the least fluctuation.

Interesting point: When all assets are looked at, every one of them, with the exception of short-term Treasury bills, on a 10-year period, any 10-year period within that 59½ years, had at least one 10-year period when both nominal and real returns were negative. That is for a 10-year period.

I don't remember exactly which 10-year period it was, whether it was 1936 to 1946 or 1926 to 1936.

However, a different picture emerges when you look at 20-year periods, 1926 to 1946 or 1947 or whatever right up to the present. If you examine those, you will see on the chart that follows page 8, the chart entitled slide IV, which looks like that, entitled "Compound Annual Rates of Return Over the Best and Worst 20-Year Periods, 1926 through 1983." I don't have the updated numbers, but the 20-year periods did not change. The best ones are still the best and the worst is still the worst.

You will find, if you look there, that there was no one class of asset in that entire period, any 20-year period in there, that actually had a negative nominal return. That is, every single class of asset for any 20-year period that you looked at had a positive nominal return, and common stocks, both Standard and Poors 500 and then another series called small stocks, the riskier ones, in the worst 20-year period in that 60 years in both cases had positive real returns as well.

That was not true of corporate bonds; that was not true of long-term government bonds, and that was not even true of Treasury bills.

That is to say, even though the volatility of stocks is much more dramatic on a short-term basis than it is for bonds or Treasury bills, over a long period of time, that volatility is dampened significantly and returns, once again, rise above the other assets, in both real and nominal terms. I think a 20-year period is not an unreasonable period to look at at all, particularly in retirement terms, during the contributing life and then during the retired life.

Senator **Eagleton**. In analyzing the investment of retirement funds, should we be focusing on nominal return or real return or what?

Mr. **Fossel**. My suggestion would be that since all of us must live, save and retire and then live while we are retired, in the real world, that is, the world of real costs, I would look at real returns. Because nominal doesn't mean anything if inflation is double digit kind of inflation and you have retirement benefits rising at 5 percent. It just doesn't help. I think we all know that. You certainly know it, and all of us know it; in my own experiences, as well, over the last 10 or 15 years.

Senator **Eagleton**. I am not trying to be offensive. This is excellent. Let me ask something this way: Suppose we, the Government, had invested the retirement funds of the civil service system about the way slide 1 depicts, with 28 percent the equity. For the private corporations, it is 50 percent plus.

Mr. **Fossel**. Right.

Senator **Eagleton**. In 1933, let's pick, 1934 or 1937, would the funds have been able to pay the retirement benefits coming due in those tragic years?

Mr. **Fossel**. Presuming that the contributions had been paid in for a significant number of years preceding any 1 bad year, the answer would be yes. That is, presuming that there had been 20 years' worth, at least 20 years' worth of contributions, the answer should have unqualifiedly been yes, because money is still coming in. Even though there might have been 1 bad year, there might have been 15 out of the preceding 20 that were particularly good years.

I think the real key is to look at the long-term results of one investment and one investment versus another.

If you are willing—and a retirement system should be willing, most systems in this country are willing and understand that—willing to accept the shorter term volatility, that is to say, to have the beneficiaries not get terribly nervous because they saw a headline on the evening news that said that the market hit a new low or something like that, but rather, were to take the approach of looking at the value of their contributions over the years, and now that they have put in for 10 or 15 or 20 years, and they see that value is higher, significantly higher, most likely, than it was in the beginning, then clearly the ability to meet any obligations in an actuarial sense is totally unhampered.

Senator EAGLETON. What about a series of bad news?

Mr. FOSSEL. That was the point of chart number IV, and that is that even if you took the worst conceivable 20-year period that existed from 1926 up to the present, which included all of the Great Depression of the 1930's, even if you took the worst 20-year period there, you would see that common stocks, in a real sense—and the worst period, interestingly, was 1962 to 1981, not some other period we might have guessed it would be—in a real sense, common stocks provided eight-tenths of 1 percent positive real return.

Where I think you would have to worry is——

Senator EAGLETON. That means benefits would have been paid all through then?

Mr. FOSSEL. They would have been paid all through that entire period, no question about that. Where someone would get hurt is if I retired today, and I took all my money out of my thrift plan, and I put it all in, for example, the common stock index fund—one version of the three alternatives that you are proposing—and if in that first year after I had invested in just that one vehicle, the stock market crashed, that wouldn't have been real smart of me, but I suppose I could have done that.

More normally, what you see as one begins to approach retirement age, they begin to shift more of their assets toward more secure, less volatile kind of assets. When you are younger, you are willing to take on a little more risk, and you want more returns, so you begin to move slowly as you go through one class of investments. That is a very normal pattern of investors, in general, whether they be pension fund investors or mutual fund investors or whatever.

Everything we have talked about so far is historical. I don't pretend to have, as I said earlier, a clear crystal ball about the future. It might be interesting to see what 126 of the country's State and local pension fund officials say, or at least they said last year. This is not current, not current in the sense that it is not this year. This is slide number V. It is headed "Rate of Return Expectations by State and Local Pension Fund Officials."

What you will see is that by and large—and I guess they were wrong, thankfully, on their view of inflation, they were a little high—but by and large, what has happened in the past, they expected to happen in the future. That is, the historical relationship between risk, as defined as volatility, and return, will be maintained. That is, in their view, at least, stocks will outperform bonds; bonds will out perform Treasury bills, and there are a couple of other classes of assets thrown in there, as well; small stocks will outperform big stocks, et cetera.

That was a 5- to 10-year look done at the time by the Greenwich Research Associates which does a lot of market research in the pension field.

I see personally no reason over the long term to expect that to change at all. The typical relationship has held up not only in this country, but in most countries around the world for a long, long period of time, which makes common sense. The more the volatility, the more the return that you are going to require as an investor. I don't see any reason that that should change.

The significance of all this, I think, as far as your committee and Congress is concerned is as follows: One, common stocks and corporate bonds in the past have and most likely will in the future offer higher long-term returns than Treasury bills or Government bonds. They are higher risk, by every definition.

Two, short-term volatility of stocks is significantly greater than bonds of all types, and the volatility of corporate bonds is greater than it is of long-term Government bonds, which, in turn, is greater than it is of Treasury bills.

Three, all investment alternatives have achieved positive, nominal returns over any 20-year period. However, only stocks have shown positive real returns for every 20-year period since 1925. Only common stocks have done that. As someone retiring, I would like to know that I could have a positive real return for maybe the 20 years that I am going to be retired.

And four, the vast majority of all 20-year periods have shown positive, nominal and real returns for all investment alternatives. So to offer a defined contribution plan or a savings plan, which is, in essence, what this is, should not frighten an employee, a contributor, or a retiree. Because even though the benefits are not guaranteed, any long-term historical analysis will show that the opportunities to achieve well-above-average returns are very high.

As I said earlier, there was one key question to ask, and that was, in essence, what was in the best interests of the employee, the retiree, and the employer? It is my strongly held opinion that the properly diversified investment portfolio or portfolios which offer a full array or a reasonably full array—you have proposed three—of prudent investment alternatives will achieve much higher investment returns than any other approach.

Additionally, the higher return can and should be attained with minimal increase in long-term volatility, obviously, some increase in shorter term volatility.

The conclusions that I come to there assume a passive investment approach or an index fund approach, if you will.

An active management of retirement system assets has the potential to enhance overall returns even further. I will concede a bias. We are by and large an active manager of pension assets and have proved to attain superior returns over time.

I think all of that is the major reason why most major corporate, union, and public sector pension plans have moved to such an approach over the last 20 years or so. When I say such an approach, I mean both diversifying their investments into not only Government bonds and corporate bonds, but stocks and, more recently, real estate and a variety of other investment alternatives.

The second trend we have seen very clearly is a move in all of those sectors to thrift plans of one form or another as an adjunct to their own defined benefit pension plan.

I would like to comment on the thrift plan itself. It is the second, or maybe it is the first, major element of the proposed act that has very clear investment implications. Whether you fall into the capital accumulation plan or a thrift plan or a savings plan, they are all the same thing. The important investment consideration here is the recognition that in a defined benefit plan, the assets or the liabilities, in essence, are owned by the employer—or in the case of the Government's system, by the taxpayers—who, ultimately therefore, will realize, that is, the employer will realize, the benefits of superior investment. returns and also will bear the cost of inadequate or inferior returns or contributions.

In a thrift plan, on the other hand, the employee owns the assets, and the employer assumes the risk and the rewards of investment returns that are realized. The major investment implication of including a thrift plan is that employees normally—and this proposed legislation does it very well—are offered a choice of investment alternatives and may tailor their own investment mix to suit their personal financial situation and their own risk tolerances.

My wife prefers to keep it under the mattress. That is her risk tolerance. A younger employee with high potential for career and earnings advancement may very well wish, in fact, I would recommend, to put a higher proportion of their assets in common stocks or some other higher risk, higher return investment, whereas another employee, who is very risk adverse, may be older and close to retirement, may wish to have those plan assets put into an assured Government bond or investment portfolio. Either individual—and I think this is one of the real pluses of this proposal—either individual has the freedom to be able to change the mix of investments as their own personal financial situation changes as they go through life.

Since the employee and the retiree have this flexibility, there obviously is a need, as you have done, to provide a series or a variety of investment choices. In my opinion, the three choices provided, at least at the outset, are entirely appropriate. That is to say, there is a very low-risk special Treasury issue fund; there is a fixed-income fund, presumably a little longer term orientation; and there is a stock index fund. As I said earlier, while I personally believe that the common stock fund should contain both a passively managed portion and an actively managed portion, I can certainly fully understand, both for cost and maybe political reasons, the reasons for only doing it on an indexed basis.

Senator EAGLETON. Do the State programs have a passive and an active fund separation such as you have described it?

Mr. FOSSEL. Most of the very large sophisticated funds these days, State and corporate, have a mix of both. That is, they have determined that the core of their investment portfolio, the pension portfolio, or a major portion of it at least, should be indexed.

Senator EAGLETON. This is a choice made by the employee or a choice made by the managers?

Mr. FOSSEL. So far, in the main, made by the manager.

Senator EAGLETON. Are you suggesting that we put into law, though, a fourth choice; that is, the first two you have mentioned and then you have corporate equity and then "fill in the box," passive funds or a high roller?

Mr. FOSSEL. I guess if you are asking me my personal opinion, I think in time you will find that employees will demand a wider variety of alternatives than merely three, and one of those might be a common stock fund that performs just like the stock market; that is, an index fund much like you have described here.

One of those alternatives that might be demanded—we found this where other employers have offered alternatives—might have something that is a little more aggressive. I wouldn't call it high roller, but high returner, how about that?

Senator EAGLETON. Of the Fortune 500 companies, you represent 30, did you say?

Mr. FOSSEL. We have as clients 31 out of the top 100.

Senator EAGLETON. Of those 31, do they have, as a choice of the employee, an active, volatile fund choice?

Mr. FOSSEL. Yes.

Senator EAGLETON. All 31 do?

Mr. FOSSEL. I wouldn't say that all 31 do, but a majority do, and the trend is clearly toward offering that as one investment alternative in a profitsharing fund. This is another version of it.

Senator EAGLETON. More employee are opting in that direction?

Mr. FOSSEL. What you find is at the outset, an employee is going to be very cautious, and usually in the early stages of a plan like that, a 401(k) plan, which is similar in many ways as well, they opt for the most conservative, or they opt for the company stock, and that is another favorite. Then as time goes by and maybe they get better educated or more sophisticated or understand better what the alternatives are, they tend to move from one place to the other.

But they start out very conservative, typically. There all always exceptions to that.

Beyond the investment issues, the narrow investment return issues, there are fairly major structural investment issues that remain. Clearly, maybe not clearly, clearly in my mind—one of the most crucial things that Congress could do in setting up a plan like this is to provide the most professional understanding and management in an investment sense of a plan that they could.

My view is that the combination of the establishment of the thrift advisory committee and the other structural steps that have been taken address very well the issues that could be of great concern relative to political involvements of the fund or conflicts and that kind of thing. I would say with no equivocation that the structure is well done at this point.

One of the other issues that comes to mind, particularly recently, but comes to mind all the time in a different form, is sort of the political influences on investing. In order for the thrift fund or funds to be best able to achieve their long-term objectives or the objectives for their participants and retirees, it is paramount that the executive director and the professional staff and the managers, the hired outside managers or internal managers, be as far removed from those issues as possible. There are too many examples, even in very recent years.

Maybe you have read some of it in the State of California, only 1 year ago, where board members or other groups that regard themselves as having something to say there have intruded themselves into the investment process of public funds and, unfortunately, often with very negative results.

That is not to say that such political or policy issues as social investing issues, whether it be to stimulate housing in rundown areas or urban revitalization or South Africa free investments or whatever they may be at a given point in time, are not legitimate considerations for the board to consider.

Senator **Eagleton**. Should we insulate any such fund against such political whims?

Mr. **Fossel**. No; I don't think you can. I had the experience of being the investment manager of the U.N. Pension Fund for the years 1973, 1974, and 1975. However political you think this one could get to be, I can assure you, that one was vastly more political.

What you can do, though, and what I think is important to do is to ensure that you have the most professional management you can and then, when there is an issue that comes up, that it can be studied in terms of the investment implications of it, if those that are the owners of the assets—in this case, in the savings plan, those that are contributing, both the employer and the employee—understand that a shift toward not investing at all in any company involved in South Africa, take the current hot button, that that has definite investment implications. I can tell you that it does.

It doesn't mean they are all bad, but it has definite investment implications, and they understand those, and they are willing to accept whatever those implications are that might be suggested. I don't think you can divorce them in any way. You have got geographical ones. I don't think they can be divorced, but I think they ought to be studied professionally as opposed to whatever ways we might respond.

Senator **Eagleton**. I know it is an issue Senator Stevens covered greater than I. We will get from you some of the analyses that have been done about—as you have said, maybe your experience with the United Nations—about the implications in South Africa and also this housing business.

I have heard it said, "Well, we have got all this money floating around these funds." My God, we could house the entire Nation and everybody could have two houses if we put the total of the retirement funds in housing. Could you get for me and maybe for the record, as well, some of the analyses that have been done of this, that you have done or that your company has done or what have you?

Mr. **Fossel**. I know I can provide you some material on South Africa, because we happen to offer a South Africa free index fund. In fact, the DC Retirement Board is the one that has invested in that very recently.

Some of the other ones I will have to look at. If I can, I will. I can say to you, and your own common sense would lead you to the same conclusion, the investment business is a supply-demand business. For some reason, we think we should not invest any money in this country, anywhere in companies that are investing or doing business in South Africa.

You know what will happen. The price of those securities will fall relative to the prices of other securities. I don't know where the equilibrium is. Maybe we are past it, maybe we are not. At some point in time, the value for an investor's point of view, regardless of anything else, is going to be in companies that are doing business 1n South Africa. The same thing would be true of mortgages on inner cities versus mortgages on farm lands. The same kinds of things would happen.

I think that the key here is to look where the value is relative to the returns and risks that are otherwise influenced by some of these shorter term trends. We don't tend to think of them when they are happening as short-term trends, but they are short-term trends in a 20-year, 25-year or 50-year time horizon. But I will look and see if I can find them for you.

One thing I feel strongly about is that no board members, in any way, shape or form, should have any ability to make specific investment decisions, the advisory board that is proposed and the oversight board as well. That ought to be left up to the professionals. They regularly ought to set policy, but not decide do we buy stock A or stock X or bond A or bond X.

I think the proposed act addresses that issue very professionally. Another concern that I have heard earlier, and I don't know if it has been a current one on this issue, is what would be the impact of even the savings plan funds investing in certain sectors of the market? Wouldn't that have a tremendous impact on the marketplace?

In my professional opinion, those fears are wholly unfounded. In the first place, the proposed act provides for a very gradual phase in to the private sector investments.

Second, the current and prospective growing size and liquidity of the United States, not to mention the worldwide financial markets, makes it highly unlikely that that impact is going to be felt in any meaningful way. I just think that is not an issue.

I think at this point, in my view, the act is in the kind of shape from an investment point of view that it ought to be in. I would make no significant revisions, and I think that all those who have worked on it, and some of them I see up there with you, have done a tremendous job. I think it is the kind of job that when it is finished and the Federal Government has in place the same kind of retirement alternatives that most of the private sector and much of the Government sector today have, it will be something that will be very attractive to those entering at age 28 in the Foreign Service, those that are in there for a long time, and those that are leaving Government service and retiring—a very beneficial long-range plus for their own retirement security.

Senator EAGLETON. My final question: Do we have any obligation—we, 100 Senators and 435 House Members—to take into account what the impact of what we may do here will have on the Federal budget? In all our districts, we were all back there in August and told everybody, time and again, how worried we are about the budget. We are concerned; we will do things about it. And people are anxious about it. We say all those things. Do we take that into account in this deliberation?

Mr. FOSSEL. It seems to me, and I will speak now as a taxpayer and a voter in Congressman Fish's congressional district, that yes, you ought to take those factors into consideration, but you ought to do so in a very long-term sense, and you ought to do so in a sense that everything that is done, whether it be spendingwise or revenuewise, has a long-term strategy to it.

As an investment professional, I would argue that by providing retirement benefits, even though part of it is a defined benefit and part is the saving plan or thrift plan, the total of which provides a higher return on those invested assets—that is, the 5 percent that the Federal Government will match, plus the 5 and up to 10 percent that the employee will contribute—than would otherwise be, and therefore, in the long run provides a savings to the Federal Government, en toto, then you have done your job.

Whether or not there is a—and I don't know if the answer is yes or no, because I am not the budget expert—but if there is a small, immediate cost in the first couple of years in beginning to put such a plan in place, which will be offset by substantially better benefits for the retirees and, therefore, lower costs to the taxpayers and to the Government, then as a voter, I applaud you.

Senator STEVENS [presiding]. I have been delighted to hear this exchange between you two. I appreciate your assisting me, Tommy, in starting the hearing.

Would you have any suggestions for us now that it appears the 401(k) is in jeopardy? Do you know of any similar plans in effect that use another thrift mechanism which would be equally effective?

Mr. FOSSEL. No; that is to say, if what you mean in the broad sense of the word is, do I know of or do I think there should be in place for the private sector an opportunity to stimulate savings and therefore provide for our own retirements by tax deferring some contribution which is then matched by the employer, do I think that ought to be a part of your system. Yes, I do, because I think that is in all of our best interests long run, whether we be taxpayers or anything else.

I, on the one hand, would hate to see 401(k) go away, because it does very clearly stimulate savings, and this country, as you all well know probably better than I, lags on a worldwide basis in our personal savings rates compared to most Europeans and certainly to Japan in terms of what they save.

Senator STEVENS. Do most of the private funds have a plan for hardship loans as this one does?

Mr. FOSSEL. I noticed that, and I don't know the answer to that question. It is the first. I haven't seen it, but I have not dug into the legal and administrative nuances of the private plans,. I really know them more from an investment point of view. So I don't know the answer to that, Senator Stevens.

Senator STEVENS. There is a considerable demand now for money to be available for short-term loans. They pay pretty high premiums for them. Do you think we should grant additional discretion to the managers to establish different types of investment portfolios such as real estate investments, short-term loans, and mortgages.

Mr. FOSSEL. You could do any of a number of things, and clearly, the trend in the pension industry, both State and local government and corporate, is to invest in a wider array of investment alternatives than used to be the case.

Equally clearly, a trend on the part of the investor is to demand a wider array of investment vehicles to suit their own particular personal financial needs. In this particular case, whatever the moneys are that are there are moneys that are owned by, ultimately owned in their entirety by the contributor; that is, the employee.

I fear a little bit, I guess, knowing how so many of us take credit cards and think we are going to pay them off and then we end up paying 18 or 20 percent and not realizing we are doing it—I kind of fear, unless it was very tightly controlled, that a loan program could be self defeating; that is, if the ultimate objective is to provide an enhanced level of retirement safety in invested assets, and then early on in the program, as those contributions were building up, an employee said, "Well, I must just have this loan against those assets" to do whatever it was that they felt like doing—hopefully, it was a well-intended purpose—but then it didn't work, and they got to retirement time and the assets they had were fully loaned and they ended up having nothing.

Senator STEVENS. I don't mean a direct loan against the assets. I mean, suppose a portion of this money were made available to Federal employee credit unions for loan capital on a commercial basis? Are there other areas of investment in which the earnings have been equal or greater to the ones that you have told me about?

Mr. FOSSEL. I would say there have been some very long-term studies on real estate—and I don't mean rural land development now, but apartments and office buildings and warehouses and investable real estate—there have been some very long-term studies that show returns, by and large, on real estate have been superior to certainly fixed-income investment, whether they be bonds or Treasury bills or whatever.

But there again, it must be a long-term return. If the fund invests in a new office building, it is many, many years before that building might be sold. Those returns, that is, both the appreciation in value plus the rentals from shopping centers and office buildings, in total, have been very, very attractive over the years.

I would suggest—in my more complete testimony I said that I think under consideration should be broadening the investment alternatives beyond what you have now proposed.

As a first step, however, and particularly in the formative stages, those three particular funds in the mix that I understand is intended are totally appropriate as the first step. I hope it will be thought of as a first step. I would hope that the board and the advisory committee and the professional managers would take it upon themselves to look at all terms that satisfy the needs and the objectives and meet the risk tolerances of the investors.

Senator STEVENS. My last question: In the private sector, when an employee leaves prior to the vesting of a pension plan and it is not a plan to which he or she has contributed, what happens to the employer contribution to the plan?

Mr. FOSSEL. Upon retirement, you mean?

Senator STEVENS. No; if they leave before vesting.

Mr. FOSSEL. Oh, before vesting? The employer contributions to the plan remain part of the plan in its entirety and, therefore, I guess you could argue, either benefit those that are still part of it and ultimately do retire, because then the assets are higher than they would have been otherwise and/or benefit the employer. If they had not vested, very clearly, the employee contributor has no call on those assets.

I have been working for 21 years, and I have never worked long enough in any one place to have vested in a pension plan. I will have to start thinking about that one of these days.

Senator STEVENS. You do very well, and we thank you very much for appearing before us. We will be back in touch with you again as we go along. Thank you very much.

Mr. FOSSEL. Thank you.

[Mr. Fossel's prepared statement follows:]

INVESTMENT IMPLICATIONS

OF

S. 1527

THRIFT SAVINGS PLAN

JON S. FOSSEL
SENIOR VICE PRESIDENT - DIRECTOR
ALLIANCE CAPITAL MANAGEMENT CORPORATION

SEPTEMBER 9, 1985

FIRST, LET ME INTRODUCE MYSELF. I AM JON FOSSEL, SENIOR VICE PRESIDENT OF ALLIANCE CAPITAL MANAGEMENT, ONE OF THE WORLD'S LARGEST INVESTMENT MANAGEMENT ORGANIZATIONS. AT ALLIANCE, WE MANAGE OVER $23 BILLION OF OTHER PEOPLE'S MONEY, THE VAST MAJORITY OF WHICH, SOME $16 BILLION IS FOR CORPORATE PENSION PLANS AND FOR STATE AND LOCAL GOVERNMENT RETIREMENT SYSTEMS. OUR CLIENTS INCLUDE 31 OF FORTUNE MAGAZINE'S TOP 100 COMPANIES, RANGING FROM AMERICAN BRANDS TO WARNER LAMBERT AND 50 GOVERNMENT RETIREMENT SYSTEMS FROM THE HAWAII EMPLOYEES RETIREMENT SYSTEM TO THE MAINE STATE RETIREMENT SYSTEM, AND HERE IN THE WASHINGTON AREA, THE DISTRICT OF COLUMBIA TEACHERS, POLICE AND FIREFIGHTERS AND JUDGES RETIREMENT BOARD AND THE STATE OF MARYLAND. OUR LIST OF CLIENTS AND THE ASSETS THEY ENTRUST TO OUR MANAGEMENT HAVE GROWN SUBSTANTIALLY OVER THE YEARS, IN LARGE PART BECAUSE OUR LONG-TERM INVESTMENT RESULTS HAVE CONSISTENTLY MET OR EXCEEDED OUR CLIENTS EXPECTATIONS. FOR EXAMPLE, DURING THE PAST TEN YEARS, OUR EQUITY ACCOUNTS ACHIEVED A COMPOUND ANNUAL RETURN OF 17.3%. THESE RESULTS COMPARE VERY FAVORABLY WITH THE CPI WHICH INCREASED 7.3% PER YEAR DURING THE SAME PERIOD, AND THE S & P "500" INDEX WHICH RETURNED 14.8% ANNUALLY.

IN ADDITION TO MY 21 YEAR INVESTMENT CAREER, I SPENT TWO TERMS IN THE NEW YORK STATE ASSEMBLY WHERE I SERVED ON THE WAYS & MEANS COMMITTEE AND THE GOVERNMENT OPERATIONS COMMITTEE, TWO YEARS AS ITS RANKING MEMBER. MY INTIMATE INVOLVEMENT WITH FISCAL, BUDGET AND RETIREMENT ISSUES IN THE NEW YORK STATE LEGISLATURE HAS GIVEN ME A FAR DEEPER UNDERSTANDING OF THE COMPLEXITY OF THE RETIREMENT ISSUES FACING CONGRESS TODAY.

My assignment for the remaining 15 minutes is to share with you my thoughts on the investment implications of certain proposed changes in the Federal Retirement System required by the Social Security Act Amendments of 1983. I should point out that my views do not necessarily represent the views of my firm, but they do probably reflect a broad consensus of investment thinking today.

INTRODUCTION

The need for Congress to address itself to alternatives to the current Civil Service Retirement Systems is abundantly clear to nearly every interested party. The actions taken by Congress prior to January 1st 1986 could have a very major impact on:

- Current and future participants.
- Current and future beneficiaries.
- The attractiveness of federal employment for existing and new workers.
- The federal budget and taxes.
- The U. S. financial markets.
- Growth in the U. S. economy.

In other words, the Steven's-Roth Proposal, or whatever alternative is finally adopted, will have a very broad and long-lasting effect on each and every American, not only for today, but for generations to come.

I WOULD LIKE TO LOOK AT THE INVESTMENT IMPLICATIONS FROM TWO QUITE DIFFERENT PERSPECTIVES. FIRST, WHAT ARE THE IMPLICATIONS OF EACH OF THE PROPOSED ACT'S MAJOR ELEMENTS.

AMONG THESE ARE:

- PRIVATE SECTOR INVESTMENTS, AND I WOULD ADD, EXPANDED PUBLIC SECTOR INVESTMENTS VS. THE PRESENT SOLE USE OF SPECIAL TREASURY ISSUES.
- DEFINED BENEFIT AND THRIFT PLAN VS. THE CURRENT DEFINED BENEFIT PLAN.
- STRUCTURAL ISSUES SUCH AS THE ROLE OF THE PENSION BOARD OF TRUSTEES.
- POLITICAL AND POLICY ISSUES SUCH AS INVESTING FOR "SOCIAL" PURPOSES.

SECONDLY, I WOULD LIKE TO COMMENT ON THE INVESTMENT IMPLICATIONS OF THE PROPOSED ACT IN TERMS OF ITS EFFECT ON THE MAJOR INTERESTED PARTIES.

AMONG THESE ARE:

- THE FEDERAL EMPLOYEE, ESPECIALLY THE NEW EMPLOYEE.
- THE FEDERAL GOVERNMENT AS THE EMPLOYER.
- THE ECONOMY AND THE FINANCIAL MARKETS.

PRIVATE SECTOR INVESTMENTS

LET ME GO BACK NOW TO THE MAJOR ELEMENTS OF THE ACT AND EXAMINE THE INVESTMENT IMPLICATIONS OF UTILIZING PRIVATE SECTOR INVESTMENTS INSTEAD OF THE CURRENT PRACTICE OF ONLY BUYING AND HOLDING SPECIAL TREASURY SECURITIES.

FIRST, LET ME SAY THAT PRIVATE VS. PUBLIC INVESTMENTS IS NOT THE RIGHT ISSUE. THE RIGHT ISSUE IS: "WHAT INVESTMENT POLICY IS BEST SUITED TO PROVIDING APPROPRIATE RETIREMENT BENEFITS TO FEDERAL RETIREES AT THE LEAST COST TO THE EMPLOYER AND CURRENT PARTICIPANTS, AT AN ACCEPTABLE LEVEL OF RISK".

IN MY OPINION, THE ANSWER TO THAT QUESTION IS THAT MOST INVESTMENTS INCLUDING: SPECIAL ISSUES, PUBLICLY TRADED TREASURY ISSUES, OTHER FEDERAL AGENCY ISSUES, CORPORATE BONDS, COMMON STOCKS, REAL ESTATE, VENTURE CAPITAL AND PROBABLY OTHER ALTERNATIVES, ARE APPROPRIATE HOLDINGS

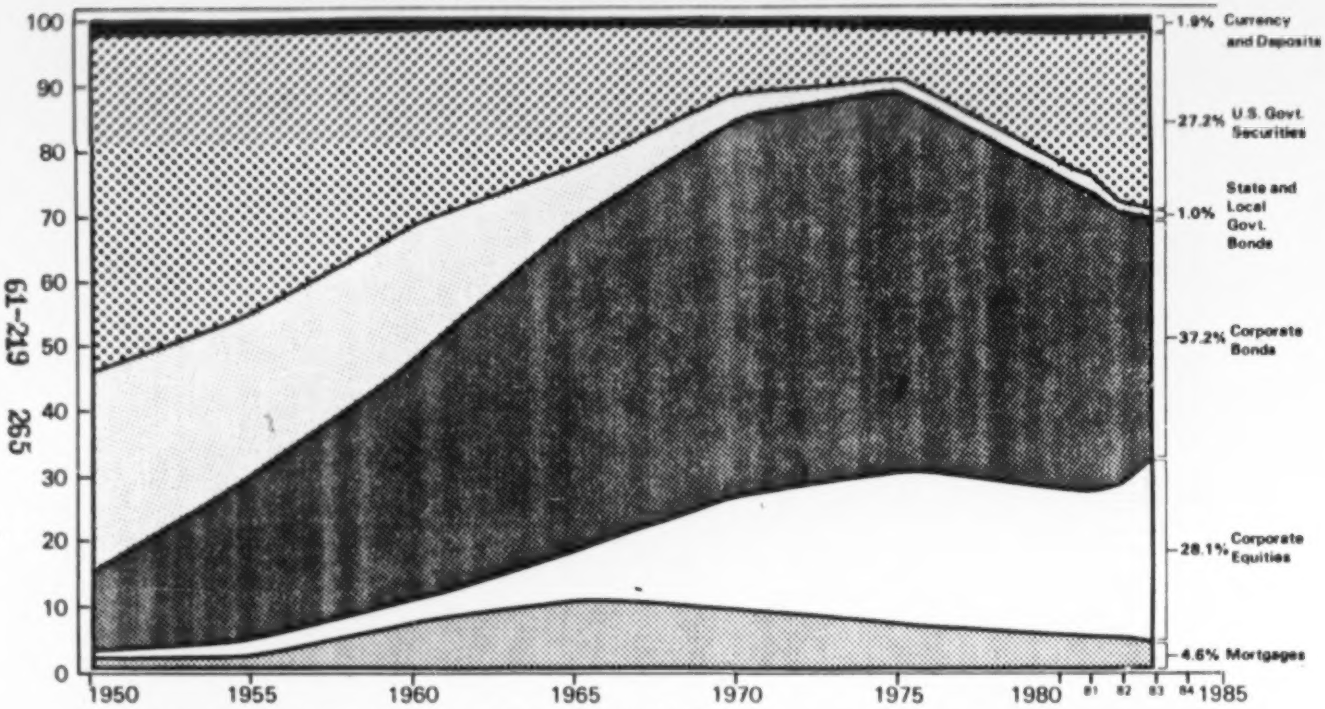
FOR A RETIREMENT SYSTEM AS LARGE AND WITH AS LONG TERM A PERSPECTIVE AS THE FEDERAL GOVERNMENT'S. THE PROPER MIX OF THE VARIOUS INVESTMENTS WILL DEPEND ON THE CHANGING MIX OF THE WORKFORCE, ACTUARIAL ASSUMPTIONS, THE NATURE OF THE PLAN OR PLANS, THE PREFERENCE OF THE EMPLOYEES, CHANGING ECONOMIC AND INVESTMENT TRENDS, AND THE PROSPECTIVE REAL RETURNS AND RISK ASSOCIATED WITH EACH ALTERNATIVE.

THE FOLLOWING CHART (SLIDE I) SHOWS HOW THE INVESTMENT MIX OF AMERICA'S STATE AND LOCAL GOVERNMENT PENSION PLANS HAVE CHANGED OVER THE PAST 33 YEARS. MUCH OF THE CHANGE IS SECULAR IN NATURE SUCH AS THE DECLINE IN STATE AND LOCAL GOVERNMENT BONDS BUT MUCH IS ALSO UNDOUBTEDLY IN RESPONSE TO CHANGING MARKET AND INVESTMENT RETURN CONDITIONS. I MIGHT NOTE THAT THE TOTAL ASSETS HELD BY THESE PUBLIC PENSION PLANS CURRENTLY EXCEEDS $300 BILLION.

A SIMILAR CHART FOR CORPORATE PENSION PLANS WOULD SHOW A VERY DIFFERENT ASSET MIX BUT SIMILAR LONG-TERM TRENDS. AS THE COST OF PROVIDING APPROPRIATE RETIREMENT BENEFITS HAS ESCALATED, PLAN SPONSORS AND THEIR INVESTMENT MANAGERS HAVE BECOME MORE SENSITIVE TO ENHANCING RETURNS WHILE AT THE SAME TIME MAINTAINING RISK AT ACCEPTABLE LEVELS. I SAY ACCEPTABLE LEVELS INSTEAD OF SAYING "MINIMIZING RISK" BECAUSE BY DEFINITION A RETIREMENT SYSTEM SHOULD HAVE A LONG-TERM INVESTMENT PERSPECTIVE. EMPLOYEES AND/OR EMPLOYERS MAKE CONTRIBUTIONS OVER A VERY LONG NUMBER OF

SLIDE I

PERCENTAGE OF
STATE AND LOCAL GOVERNMENT
PENSION PLANS INVESTED AMONG VARIOUS ASSETS, 1950 - 1983*



* All values shown are at cost (except corporate equities) Corporate equities are shown at market value

Source: Federal Reserve Board Flow of Funds Accounts

Alliance

61-219 265

YEARS AND BENEFICIARIES USUALLY RECEIVE BENEFITS FOR MANY YEARS. THEREFORE, IN ORDER TO IMPROVE BENEFITS AND/OR REDUCE COSTS THROUGH ATTAINMENT OF HIGHER RETURNS THE ASSUMPTION OF SOME SHORTER-TERM VOLATILITY (OR RISK) IS PERFECTLY APPROPRIATE (AND PRUDENT).

THE FOLLOWING TABLE (SLIDE II) ILLUSTRATES THE COMPOUND ANNUAL RETURN ACHIEVED FROM THE FOUR MAJOR CLASSES OF INVESTMENT ASSETS OVER THE PAST 59 YEARS.

59 YEARS WHICH INCLUDED:

- 2 DECLARED WARS
- 1 DEPRESSION
- MORE THAN A DOZEN RECESSIONS
- AN ENERGY CRISIS
- 1 PRESIDENTIAL ASSASSINATION AND 1 NEAR MISS
- DEFLATION, INFLATION, STAGFLATION AND NOW DISINFLATION

IN OTHER WORDS, HARDLY A PLACID PERIOD.

SLIDE II

STOCK, BONDS, RISK FREE ASSETS, & INFLATION
COMPOUND GROWTH RATES, 1926-[illegible] 6/30 1985

	NOMINAL	REAL
COMMON STOCKS (S&P 500)	~~9.8%~~ 9.7%	6.6%
LONG-TERM CORPORATE BONDS	~~4.2%~~ 4.6%	~~1.2%~~ 1.5%
LONG-TERM GOVERNMENT BONDS	~~3.5%~~ 3.9%	~~0.5%~~ 0.8%
TREASURY BILLS	~~3.2%~~ 3.4%	~~0.2%~~ 0.3%
INFLATION	~~3.0%~~ 3.1%	–

Source: University of Chicago

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And yet the riskiest (or most volatile) asset, common stocks, achieved the highest return by three times as much per year as U. S. Treasury Bills, an ostensibly risk-free investment, which is also a virtually return free investment, in real terms.

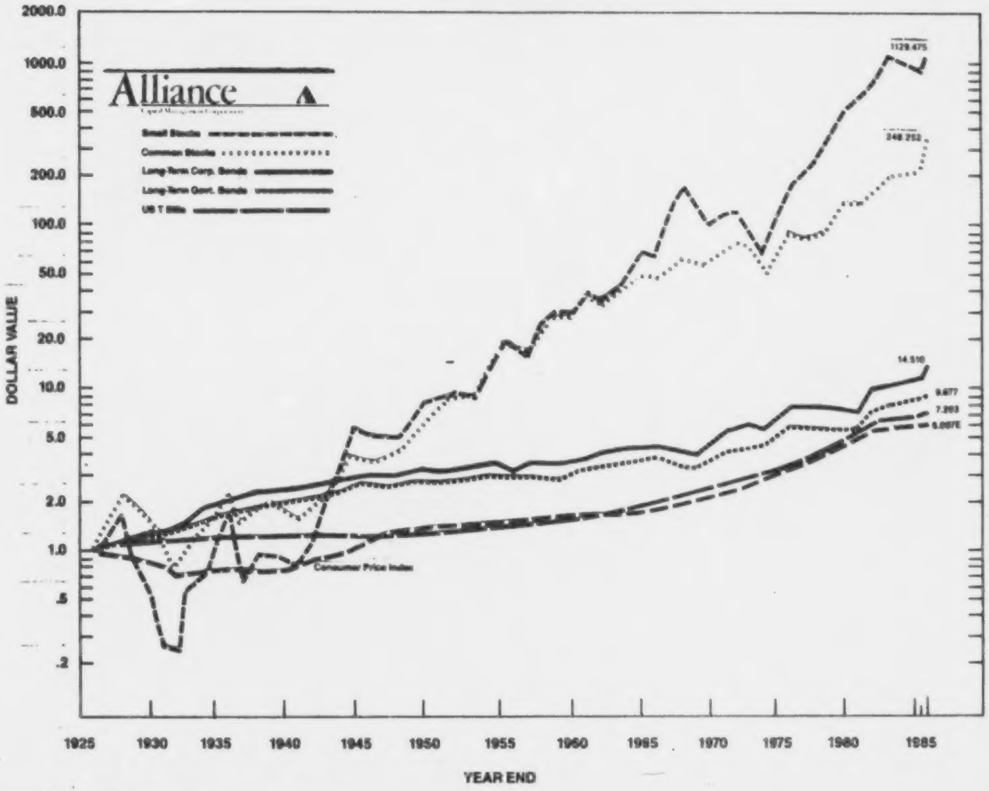
The next chart (SLIDE III) shows dramatically the long-term impact of compounding a given dollar of investment at a high rate.
The chart shows that one dollar invested in common stocks at the end of 1925 would have been worth $248.25 by June 30th 1985 whereas that same dollar invested in long-term corporate bonds would be worth $14.51, $9.68 if in long-term government bonds and $7.20 if in Treasury bills. Obviously, the impact of higher returns has significant positive implications for employee and employer alike, especially since the purchasing power of the dollar was cut by nearly 85%.

The graph, however, shows something else as well, and that is how much more volatile the shorter-term return from stocks has been when compared to less risky investment alternatives. Over this period, the annual return for stocks ranged from +54% in 1933 to -43% in 1931, whereas long-term government bond returns ranged from +30% in 1932 to -16% in 1946.

All classes of assets except short-term Treasury bills had at least one ten year period when both nominal and real returns were negative.

SLIDE III

WEALTH [illegible]ICES OF INVESTMENT IN THE U.S. CAPITAL MARKETS
1926—1983



Source: Stocks, Bonds, Bills & Inflation: 1984 Yearbook R.G. Ibbotson Associates, Chicago, 1984

HOWEVER, A DIFFERENT PICTURE EMERGES WHEN TWENTY YEAR HOLDING PERIODS ARE EXAMINED. AS THE FOLLOWING TABLE (SLIDE IV) SHOWS, EVERY CLASS OF ASSET HAD A POSITIVE NOMINAL RETURN FOR ANY TWENTY YEAR PERIOD.

THIS TABLE IS DRAMATIC EVIDENCE OF THE HIGHER LONG-TERM RETURNS THAT IS LIKELY TO BE FOUND IN MORE RISKY (THAT IS MORE VOLATILE ASSETS) AND ALSO SHOWS THAT OVER LONGER TIME PERIODS THE RISK OF NEGATIVE RETURNS FROM COMMON STOCKS, THE MOST VOLATILE ASSETS, HAS BEEN WELL WITHIN ACCEPTABLE AND PRUDENT LIMITS IN FACT, THERE HAVE BEEN 20 YEAR PERIODS WHEN THE ALLEGEDLY SAFEST INVESTMENTS, TREASURY BILLS, HAVE LOST MONEY IN REAL TERMS. THIS HAS NOT BEEN THE CASE WITH STOCKS.

WHILE THE PRECEDING ANALYSIS IS HISTORICAL, IT MIGHT BE INSTRUCTIVE TO TAKE A LOOK INTO THE FUTURE THROUGH THE EYES OF 126 OF THE COUNTRY'S LARGEST STATE AND LOCAL GOVERNMENT PENSION FUND OFFICIALS.

THE TABLE (SLIDE V) SHOWS THAT FOR THE NEXT 5-10 YEARS, THESE FUNDS EXPECT THE HISTORICAL RELATIONSHIP BETWEEN RISK AND RETURN TO BE MAINTAINED, WITH THE MORE VOLATILE INVESTMENTS, EMERGING GROWTH STOCKS, TO OFFER FAR HIGHER RETURNS THAN LOW RISK INVESTMENTS SUCH AS TREASURY BILLS. I MIGHT ADD A PERSONAL OPINION HERE, WHICH IS THAT I BELIEVE THE TOTAL RETURN REALIZED BY LONG-TERM HIGH YIELDING, HIGH QUALITY BONDS WILL EXCEED RETURNS FROM COMMON STOCKS OVER THE NEXT SEVERAL YEARS ON A RISK

SLIDE IV

COMPOUND ANNUAL RATES OF RETURN OVER BEST/WORST 20 YEAR PERIODS
(1926-1983)

	Best 20 Years		Worst 20 Years	
	Nominal	Real	Nominal	Real
Small Stocks	21.1% (1942-61)	17.2% (1942-61)	5.7% (1929-48)	4.0% (1929-48)
Common Stocks	16.9% (1942-61)	13.0% (1942-61)	3.1% (1929-48)	0.8% (1962-81)
Long Term Corporate Bonds	5.5% (1926-45)	5.4% (1926-45)	1.3% (1950-69)	-2.7% (1962-81)
Long Term Government Bonds	4.7% (1926-45)	4.6% (1926-45)	0.7% (1950-69)	-3.1% (1962-81)
Treasury Bills	6.1% (1962-81)	1.0% (1952-71)	0.4% (1931-50)	-3.1% (1933-52)
Inflation	5.9% (1962-81)		0.1% (1926-45)	

SOURCE: *Stocks, Bonds, Bills and Inflation: 1984 Yearbook*, R.G. Ibbotson Associates, Chicago, 1984.

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SLIDE 4

RATE OF RETURN EXPECTATIONS BY STATE AND LOCAL PENSION FUND OFFICIALS

Base: 126

	90-Day Treasury Bills	S&P 500 Stock Average	Established Growth Stocks	Emerging Growth Stocks	Buy-and-Hold Corporate Bonds	Actively Managed Corporate Bonds	Equity Real Estate	Real Estate Mortgages
Mean	8.9%	12.5%	14.3%	15.9%	10.0%	11.4%	12.0%	10.7%
Median	8.8%	11.5%	13.5%	15.5%	9.8%	11.5%	10.5%	11.5%

Source: Greenwich Research Associates, *Public Pension Funds 1984 Market Dynamics Report.*

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Capital Management Corporation

ADJUSTED BASIS. THAT IS TO SAY, AS AN ACTIVE MANAGER OR A BOARD MEMBER OF THE NEW CIVIL SERVICE RETIREMENT SYSTEM, I WOULD HAVE A VERY LARGE PORTION OF THE FUND INVESTED IN BONDS TODAY, BUT WOULD ARGUE STRONGLY FOR THE FLEXIBILITY TO CHANGE ASSET MIX AS INVESTMENT OPPORTUNITIES CHANGE.

THE SIGNIFICANCE OF THE HISTORICAL AND PROSPECTIVE RETURNS REALIZED BY VARIOUS INVESTMENT ALTERNATIVES ARE THE FOLLOWING:

1. COMMON STOCKS AND CORPORATE BONDS HAVE IN THE PAST, AND WILL PROBABLY IN THE FUTURE, OFFER HIGHER LONG-TERM RETURNS THAN TREASURY BILLS OR LONG-TERM GOVERNMENT BONDS.

2. THE SHORT-TERM VOLATILITY OF STOCKS IS SIGNIFICANTLY GREATER THAN BONDS OF ALL TYPES.

3. ALL INVESTMENT ALTERNATIVES HAVE ACHIEVED POSITIVE NOMINAL RETURNS OVER ANY TWENTY-YEAR PERIOD. HOWEVER, ONLY STOCKS HAVE SHOWN POSITIVE REAL RETURNS FOR EVERY TWENTY-YEAR PERIOD SINCE 1925.

4. THE VAST MAJORITY OF TWENTY-YEAR PERIODS SHOWED POSITIVE NOMINAL AND REAL RETURNS FOR ALL INVESTMENT ALTERNATIVES.

SINCE, AS MENTIONED EARLIER, A LONG-TERM TIME HORIZON IS APPROPRIATE FOR THE FEDERAL RETIREMENT SYSTEM, IT IS MY STRONGLY HELD OPINION THAT A PROPERLY DIVERSIFIED INVESTMENT PORTFOLIO UTILIZING A FULL ARRAY OF PRUDENT INVESTMENT ALTERNATIVES WILL ACHIEVE MUCH HIGHER INVESTMENT RETURNS THAN ANY OTHER APPROACH. ADDITIONALLY, THE HIGHER RETURN CAN AND SHOULD BE ATTAINED WITH MINIMAL INCREASE IN LONG-TERM VOLATILITY. THE ABOVE CONCLUSIONS ASSUME A PASSIVE INVESTMENT APPROACH, OBVIOUSLY ACTIVE MANAGEMENT OF THE RETIREMENT SYSTEMS ASSETS HAS THE POTENTIAL TO ENHANCE OVERALL RETURNS EVEN FURTHER.

AN ACTIVELY MANAGED INVESTMENT APPROACH UTILIZING ALL INVESTMENT ALTERNATIVES, FROM TREASURY BILLS AND BONDS, TO GOVERNMENT AGENCY AND CORPORATE BONDS, TO MORTGAGES AND REAL ESTATE TO THE FULL ARRAY COMMON STOCKS IS THE APPROACH THAT BEST ANSWERS THE QUESTION I POSED EARLIER WHICH WAS "WHAT INVESTMENT POLICY IS BEST SUITED TO PROVIDING APPROPRIATE RETIREMENT BENEFITS TO FEDERAL RETIREES AT THE LEAST COST TO THEIR EMPLOYER AND CURRENT PARTICIPANTS, AT AN ACCEPTABLE LEVEL OF RISK?"

THIS IS WHY MOST MAJOR CORPORATE UNION AND PUBLIC SECTOR PENSION PLANS HAVE MOVED TO SUCH AN APPROACH OVER THE PAST TWENTY YEARS OR SO.

THRIFT PLAN

THE SECOND MAJOR ELEMENT OF THE PROPOSED ACT THAT HAS INVESTMENT IMPLICATIONS IS THE CREATION OF A CAPITAL ACCUMULATION OR THRIFT PLAN AS AN ADJUNCT TO A DEFINED BENEFIT PLAN.

THE IMPORTANT INVESTMENT CONSIDERATION IS THE RECOGNITION THAT IN A DEFINED BENEFIT PLAN THE ASSETS OR LIABILITIES ARE, IN ESSENCE, OWNED BY THE EMPLOYER (OR IN THE CASE OF GOVERNMENT SYSTEMS, THE TAXPAYERS) WHO THEREFORE WILL REALIZE THE BENEFITS OF SUPERIOR INVESTMENT RETURNS AND ALSO BEAR THE COST OF INADEQUATE RESULTS AND/OR INSUFFICIENT CONTRIBUTIONS. IN THRIFT PLANS, ON THE OTHER HAND, THE EMPLOYEE OWNS THE ASSETS AND ASSUMES THE RISK AND REWARDS OF THE INVESTMENT RETURNS REALIZED. THE MAJOR INVESTMENT IMPLICATION OF INCLUDING A THRIFT PLAN IS THAT USUALLY EMPLOYEES ARE OFFERED A CHOICE OF INVESTMENT ALTERNATIVES AND MAY TAILOR THEIR INVESTMENT MIX TO SUIT THEIR PERSONAL FINANCIAL SITUATION AND RISK TOLERANCE. A YOUNGER EMPLOYEE, WITH HIGH POTENTIAL FOR CAREER ADVANCEMENT, MAY WISH TO HAVE A HIGHER PORTION OF ASSETS INVESTED IN COMMON STOCKS OR REAL ESTATE, WHEREAS, ANOTHER EMPLOYEE WHO IS CLOSER TO RETIREMENT, MAY WISH TO HAVE PLAN ASSETS INVESTED IN MORE CONSERVATIVE GOVERNMENT BONDS OR TREASURY BILLS. EITHER INDIVIDUAL COULD HAVE THE FREEDOM TO CHANGE THE MIX OF ASSETS IN THEIR PLAN AS PERSONAL FINANCIAL SITUATIONS CHANGE.

SINCE THE EMPLOYEE AND RETIREE HAS THIS FLEXIBILITY, THERE WILL OBVIOUSLY BE A NEED TO PROVIDE A VARIETY OF INVESTMENT CHOICES AND THE PROPOSED LEGISLATION DOES SO. THE THREE CHOICES PROVIDED ARE ENTIRELY APPROPRIATE - AT LEAST AT THE OUTSET. WHILE I PERSONALLY BELIEVE THAT THE COMMON STOCK FUND SHOULD CONTAIN BOTH A PASSIVELY MANAGED OR INDEXED PORTION AND AN ACTIVELY MANAGED SEGMENT, I CAN FULLY APPRECIATE THE POLITICAL AND COST REASONS TO UTILIZE ONLY AN INDEX FUND. IN THIS CASE, I WOULD STRONGLY SUGGEST THAT FIXED INCOME FUND FOLLOW A SIMILAR APPROACH.

ONCE THE MAJOR ISSUES OF INVESTMENT APPROACH AND PLAN STRUCTURE ARE RESOLVED, SOME OF THE TOUGHEST HURDLES STILL REMAIN. THESE ARE WHAT I CALL THE STRUCTURAL, POLITICAL AND POLICY ISSUES.

STRUCTURAL ISSUES

TAKING THE STRUCTURAL ISSUES FIRST, IT IS CLEARLY IN THE BEST INTEREST OF ALL CONCERNED TO SET UP THE CIVIL SERVICE THRIFT INVESTMENT BOARD IN SUCH A WAY AS TO PROVIDE THE MOST PROFESSIONAL UNDERSTANDING OF PENSION AND INVESTMENT ISSUES. THERE IS AMPLE PRECEDENT FOR THE ESTABLISHMENT OF SUCH A BOARD TO BE FOUND IN MANY OF THE STATE SYSTEMS IN THIS COUNTRY, AS WELL AS A NUMBER OF MULTI-NATIONAL EMPLOYERS SUCH AS THE UNITED NATIONS.

WHEN I PREVIOUSLY TESTIFIED ON AN EARLIER VERSION OF S. 1527, IT WAS

MY VIEW THAT THE BOARD SHOULD CONSIST OF EMPLOYEE, EMPLOYER AND POLITICAL REPRESENTATIVES AND SHOULD ASSUME BROAD POLICY MAKING AND OVERSIGHT RESPONSIBILITIES INCLUDING:

- INVESTMENT POLICY FORMULATION.
- ASSET ALLOCATION.
- LEGAL AND CONTRACTUAL OVERSIGHT.
- HIRING THE EXECUTIVE DIRECTOR.

THE ESTABLISHMENT OF A THRIFT ADVISORY COMMITTEE IS A VERY APPROPRIATE WAY TO PROVIDE PROFESSIONAL INVESTMENT INPUT.

AT THAT TIME, I FELT THAT CONTRARY TO THE PROVISIONS OF THE PROPOSED ACT, THE EXECUTIVE DIRECTOR SHOULD BE HIRED BY THE BOARD AND THAT EMPLOYEES, BOTH CURRENT AND RETIRED, SHOULD HAVE BROADER REPRESENTATION ON THE BOARD.

THE CURRENT LEGISLATION FULLY ADDRESSES THESE CONCERNS. ONE OF THE MOST IMPORTANT STRUCTURAL ISSUES TO BE FACED IS WHETHER THE FUND'S ASSETS SHOULD BE MANAGED BY A PROFESSIONAL, INTERNAL STAFF OR BY EXTERNAL INVESTMENT MANAGERS. THERE ARE PRO'S AND CON'S IN EACH APPROACH, AND AS YOU CAN SEE IN THE FOLLOWING TABLE (SLIDE VI), PUBLIC FUNDS IN THE U. S.

SLIDE VI

HOW MANAGEMENT OF PUBLIC FUNDS VARIES WITH FUND CHARACTERISTICS

	Base	Internal Management	Advisory Management	Discretionary Management
Type of Fund				
State funds	(70)	70%	49%	46%
Municipal funds	(170)	42%	32%	66%
Large municipal	(36)	47%	56%	61%
Plan Assets				
Over $500 million	(68)	69%	50%	49%
Type of Management				
Internal	(32)	100%	0%	0%
Advisory	(26)	0%	100%	0%
Discretionary	(79)	0%	0%	100%
Number of Employees				
Over 20,000	(63)	65%	44%	52%

SOURCE: Greenwich Research Associates, *Public Pension Funds 1984 Market Dynamics Report*

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USE BOTH INTERNAL AND EXTERNAL MANAGEMENT ON BOTH AN ADVISORY AND DISCRETIONARY BASIS. MANY MAJOR FUNDS CONTRACT OUT MANAGEMENT OF CERTAIN ASSETS ESPECIALLY THE MORE COMPLEX INVESTMENTS SUCH AS STOCKS AND REAL ESTATE, WHILE RETAINING INTERNAL MANAGEMENT FOR SHORT-TERM INVESTMENTS AND PERMANENT LONG-TERM INVESTMENTS.

EVEN THOUGH I HAVE A BIAS TOWARD PROFESSIONAL, EXTERNAL MANAGEMENT BECAUSE OF THE CRITICAL IMPORTANCE OF ATTRACTING AND RETAINING AN OUTSTANDING INVESTMENT STAFF, I BELIEVE THAT A FUND AS LARGE AS THE FEDERAL GOVERNMENT RETIREMENT SYSTEM COULD VERY WELL FIND IT COST EFFECTIVE TO PERFORM CERTAIN INVESTMENT FUNCTIONS ITSELF, AND IN ANY EVENT, SHOULD HAVE A HIGHLY COMPETENT INVESTMENT PROFESSIONAL AS EXECUTIVE DIRECTOR. YOUR LEGISLATION PROVIDES FOR THIS.

POLITICAL AND POLICY ISSUES

IN ORDER FOR THE FUND TO BE BEST ABLE TO ACHIEVE ITS LONG RANGE OBJECTIVES FOR ITS PARTICIPANTS, IT IS PARAMOUNT THAT THE EXECUTIVE DIRECTOR, THE PROFESSIONAL STAFF AND EXTERNAL MANAGERS BE AS FAR REMOVED FROM POLITICAL INFLUENCE AND INTERFERENCE AS POSSIBLE. THERE ARE TOO MANY EXAMPLES, EVEN IN THE VERY RECENT PAST WHERE BOARD MEMBERS OR OTHER OUTSIDE GROUPS INTRUDED INTO THE INVESTMENT PROCESS OF PUBLIC FUNDS WITH QUITE NEGATIVE RESULTS.

THIS IS NOT TO SAY THAT SUCH POLICY/POLITICAL ISSUES SUCH AS "SOCIAL INVESTING", I.E. HOUSING STIMULUS, URBAN REVITALIZATION, SOUTH AFRICA ETC. ARE NOT LEGITIMATE CONSIDERATIONS FOR THE BOARD. THEY ARE. HOWEVER, IT MUST BE RECOGNIZED THAT VIRTUALLY EVERY INVESTMENT POLICY DECISION HAS THE POTENTIAL TO IMPACT THE RETURN AND/OR RISK REALIZED ON THE FUND'S INVESTMENTS, AND THEREFORE, THE BOARD MUST ADDRESS THESE ISSUES WITH THE INTEREST OF THE RETIREMENT SYSTEM'S CONTRIBUTORS AND BENEFICIARIES CLEARLY IN MIND.

IN NO EVENT SHOULD THE BOARD MEMBERS OR ANYONE ELSE OTHER THAN THOSE SPECIFICALLY VESTED WITH THE PROPER AUTHORITY HAVE THE ABILITY TO MAKE INVESTMENT DECISIONS. THE PROPOSED ACT HAS ADDRESSED THIS ISSUE QUITE PROPERLY.

ANOTHER MAJOR POLICY CONCERN IS THE POSSIBILITY THAT THE FUND MIGHT CONTROL THE MARKET OR CERTAIN SECTORS OF THE MARKET.

IN MY OPINION, THESE FEARS ARE WHOLLY UNFOUNDED. IN THE FIRST PLACE, THE PROPOSED ACT PROVIDES FOR A VERY GRADUAL PHASE IN THE PRIVATE SECTOR INVESTMENTS. SECONDLY, THE CURRENT AND PROSPECTIVE SIZE AND LIQUIDITY OF THE U. S. FINANCIAL MARKETS MAKE IT HIGHLY UNLIKELY THAT ANY RESPONSIBLY MANAGED FUND, EVEN ONE OF THIS SIZE COULD HAVE UNDUE INFLUENCE ON THE MARKET. THIRDLY, IT IS HIGHLY LIKELY THAT THE FUND'S ASSETS WILL BE

WIDELY DIVERSIFIED AMONG GOVERNMENT AND CORPORATE BONDS, REAL ESTATE, MORTGAGES AND A LARGE NUMBER OF COMMON STOCKS, NOT CONCENTRATED IN ANY ONE SEGMENT.

ON THE SURFACE, IT APPEARS THAT THE MULTIPLICITY OF STRUCTURAL, POLITICAL AND POLICY ISSUES AFFECTING THE FUND'S INVESTMENT APPROACH ARE SO COMPLEX AND CONTROVERSIAL THAT IT WOULD BE EASY TO CONCLUDE THAT IT'S JUST NOT WORTH UNDERTAKING MAJOR CHANGE. WE MUST REMEMBER, HOWEVER, THAT THERE IS A RESPONSIBILITY TO CURRENT AND FUTURE RETIREES THAT IS PARAMOUNT. MOST OF AMERICA'S MAJOR CORPORATIONS, OUR 50 STATES, MOST OTHER MAJOR POLITICAL SUBDIVISIONS AND OUR LARGEST LABOR UNIONS HAVE ALREADY CHOSEN A COURSE THAT UTILIZES MODERN INVESTMENT MANAGEMENT APPROACHES AND PRIVATE SECTOR INVESTMENTS.

THEY HAVE DONE SO BECAUSE IT IS IN THE LONG-TERM BEST INTEREST OF THEIR CURRENT, FUTURE AND RETIRED EMPLOYEES. YOUR PROPOSAL PROVISION OF A THRIFT PLAN WITH A CHOICE OF INVESTMENT ALTERNATIVES IS A VERY BENEFICIAL PROVISION FOR FEDERAL WORKERS--CURRENT AND FUTURE.

FOR THE EMPLOYEE, IT PROVIDES THE OPPORTUNITY TO TAILOR THEIR RETIREMENT PROGRAMS TO THEIR INDIVIDUAL NEEDS, AND TO ADJUST THE INVESTMENT MIX IN THEIR ACCOUNT TO REFLECT CHANGING PERSONAL FINANCIAL CIRCUMSTANCES. ADDITIONALLY, THE CONTRIBUTIONS TO EACH EMPLOYEE'S

INDIVIDUAL THRIFT ACCOUNT WILL BE OWNED BY THE EMPLOYEE, WILL BE PORTABLE IN THE EVENT THE EMPLOYEE CHANGES JOBS, AND WILL THEREFORE BE INSULATED FROM POLITICAL OR BUDGETARY UNDERMINING.

WHILE IT IS TRUE THAT THE INVESTMENT RISK AS WELL AS THE REWARD OF THE INVESTMENT RESULTS ARE BORNE BY THE EMPLOYEE IN THE THRIFT PLAN, IT IS ALSO TRUE THAT THE PLAN PROVIDES A LOW RISK INVESTMENT ALTERNATIVE. FURTHERMORE, AS DISCUSSED EARLIER, IT IS HIGHLY LIKELY THAT THE LONG-TERM RETURNS FROM A PROFESSIONALLY MANAGED, WELL DIVERSIFIED FUND WILL EXCEED THE RETURNS FROM AN UNMANAGED FUND INVESTING ONLY IN SPECIAL TREASURY ISSUES. THIS IS NOT ONLY BECAUSE RETURNS FROM OTHER INVESTMENTS WILL, IN ALL LIKELIHOOD CONTINUE TO BE HIGHER OVER LONG TIME PERIODS, BUT EQUALLY IMPORTANT, BECAUSE ASSET MIX CAN BE ALTERED TO REFLECT ECONOMIC, MARKET, INFLATIONARY AND INTEREST EXPECTATIONS.

IN CONCLUSION, THE PROPOSED CIVIL SERVICE PENSION REFORM ACT IS AN IDEA WHOSE TIME IS LONG OVERDUE. IT WILL GO A LONG WAYS TOWARD BRINGING THE FEDERAL RETIREMENT SYSTEM INTO THE MODERN AGE. SOME OF THE SHORT-TERM POLITICAL HURDLES WILL BE TOUGH TO OVERCOME, BUT A GOOD START IS BEING MADE AND THE LONG-TERM BENEFITS SHOULD BE OBVIOUS TO ALL CONCERNED.

[Short recess.]

Senator **Stevens**. We apologize for the delay. As I indicated, it looks like there will be a series of votes. Senator Eagleton and I are going to try to work it out so that we can keep the hearings going. We hope you will understand our situation.

The next witnesses are our good friends, Ken Blaylock and Moe Biller.

Did you flip a coin? Who is going to go first?

TESTIMONY OF MOE BILLER, PRESIDENT, AMERICAN POSTAL WORKERS UNION (AFL-CIO), ACCOMPANIED BY PATRICK J. NILAN, LEGISLATIVE DIRECTOR, AND ROY BRAUNSTEIN, LEGISLATIVE AIDE; AND KENNETH T. BLAYLOCK, PRESIDENT, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES (AFL-CIO), ACCOMPANIED BY VIRGIL MILLER, REGIONAL VICE PRESIDENT, AND ARNIE ANDERSON, ECONOMIST

Mr. **Blaylock**. Mr. Biller is going to go first. My mama taught me the respect of age.

Mr. **Biller**. I appreciate that.

Senator **Stevens**. Thank you very much.

Mr. **Biller**. Thank you Mr. Chairman. Thank you for inviting me to testify before you today on behalf of the 325,000 members of the American Postal Workers Union.

"Union" means we stand together. Therefore, I am here to speak on behalf of all our members, the new hires in the good system and the pre-1984 employees who do not want their current system undermined.

The American Postal Workers Union supports action in this Congress on a supplemental plan. Most of this spring and summer, postal and Federal employees and retirees have felt that their retirement program was in the hands of budget hijackers who were threatening to do it harm. Enactment of the budget resolution has set the hostage free, at least temporarily. We can now consider this legislation without a budget gun at the head of the retirement program.

If a supplemental plan is not enacted, new hires will eventually have to pay the full payroll deductions for both civil service retirement and Social Security. We don't want to see that happen any more than Members of Congress do. However, we will not accept a stingy, inadequate plan. It is the duty of this committee to stand up with us and oppose the far right's demagoguery of our Federal and postal compensation.

The Reagan administration has been no help in developing an adequate retirement plan for new hires. Mr. Devine and Mr. Grace may have high-sounding names, but they took the low road on policies for public service workers. Hiding behind the mantle of authority and respectability given to them through appointment by this administration, Mr. Devine and Mr. Grace continue to spread confusion and falsehoods about the civil service retirement program.

One of their most frequent charges is that an unfunded liability in civil service retirement means the program is overly expensive or unsound. A recent article in the National Journal clearly demonstrated how much baloney there is in that false charge.

The former OPM Director floated a proposal a few months ago that meant there would have been severe reductions in the civil service retirement benefit. I am glad the Congress has not given it serious consideration.

The only legislation from the administration that has been introduced in either House is their long list of budget cuts. They are radical, right wing, and not worthy of consideration. Congress should continue to look the other way when it comes to considering this administration's destructive proposals.

Peter Grace and the so-called Grace Commission constitute another arm for this administration's attacks on Federal and postal workers and retirees.

A joint study by the General Accounting Office and the Congressional Budget Office found that the Commission greatly overstated the cost savings attainable under its recommendations. Even without considering the merits of the proposals, the CBO–GAO review found that the savings Grace claimed were three times the level of savings actually possible. GAO further stated, and I quote, that it "does not find the package of the PPSSCC recommendations a sound basis for restructuring civil service retirement," end of quote.

I am appalled that, despite these findings by nonpartisan experts, Grace is still flying around the country with a taxpayer subsidy spreading his misinformation and sowing seeds of prejudice against public service employees.

The CBO–GAO report made an additional recommendation that the Senate Budget and Governmental Affairs Committees apparently chose to ignore this year. The report stated that changes in retirement would be "consistent and complementary * * * if the Congress deferred action until the legislative committees acted on the changes for newly hired workers."

Despite this recommendation, some members of both the Budget Committee and this committee worked actively to use the budget process to force large cuts in civil service retirement. Postal workers are thankful that the conferees saw the wisdom of agreeing with the House position in this area.

With respect to the supplemental retirement plan for new hires, the APWU has been preparing itself to participate fully in the development of a supplemental plan. We participated fully in this committee's policy forums and were pleased with one of the main results: namely, that the Stevens-Roth legislation incorporates a defined benefit as an important, integral part of the supplemental plan.

Earlier this year, it was rumored in the press that Senator Stevens had a bill that was going to be introduced. However, that legislation was never introduced, so we were not able to offer our reactions through testimony. We are pleased that the process is now finally underway.

I want to begin my remarks on the specifics of the Stevens-Roth bill by asking a fundamental question: Why would you want to cut civil service retirement? It is a good program. It is not the best in the country, and if Congress keeps chipping away at it, it will get worse.

The Hay-Huggins study conducted for the House Post Office and Civil Service Committee brings out two facts that we believe are definitive in answering the question of whether the new hire supplemental program should be made better or worse than the existing retirement program.

The Hay-Huggins study found that total average Federal compensation lagged behind the average for private firms by 7.2 percent. The greatest contributing factor to this lag is Federal pay, which the study found to be 10.3 percent behind the private sector.

This lag in pay was made up partially by the fact that the civil service retirement and other benefits are worth 2.8 percent of pay more than the average fringe benefits in the private sector. That is 2.8 percentage points above average. That is not overly generous or way out of line like Peter Grace would have us believe.

Members of this committee should be aware that when Hay-Huggins looked at the retirement plans of the 854 companies in its study, it found that over 10 percent of the group had retirement benefits that were better than civil service retirement. That means that there are at least 85 companies out there with a better retirement program than civil service retirement.

The Federal and Postal Services are large organizations. They have to compete for good employees like any other organization. The President has frozen Federal pay for 1986, so that the salary lag identified by Hay-Huggins will grow larger. Now is not the time for the Congress to make retirement cuts and further undermine the competitive position of the Federal employer.

The Stevens-Roth bill offers a framework on which to draft a good supplemental plan. However, the bill proposes a system that is inadequate in several important ways.

The estimated cost of 20.8 percent of payroll implies that the plan's value will be one-sixth less than that of the current system. We favor a supplemental that has a total value comparable to the current program, or 25 percent of payroll.

The proposed COLA of CPI minus 2 will work a serious financial hardship on retirees. For example, if you retired on a CPI minus 2 COLA and lived 20 more years, the real value of your retirement pension would be one-third less. A pension should be as good at age 82 as it was at age 62. I'm well on the road. COLA cuts of this type have been tried repeatedly in recent years, and all of them ultimately have been defeated. This proposal should meet the same fate.

We cannot accept the proposal to reduce the benefit for the 30-year employee who is eligible to retire at age 55. The average employee retires at age 61. This proposal would affect only the minority who began Government careers at early ages and loyally remained in their jobs. An adequate retirement after such a long career is essential to our members. Continued full benefits at age 55 would add little to the cost of S. 1527. The Congressional Research Service estimates a cost at only one-half of 1 percent of payroll.

The proposed matching rate on employee contributions to the capital accumulation plan is far in excess of typical private sector practice. We favor less matching for the CAP. Instead, a higher accrual rate for the defined benefit supplemental should be offered so that the average worker can be assured of a decent retirement whether or not he or she has been able to put money into the CAP.

We are particularly concerned that the CAP not be overemphasized in light of the tax reform suggestion last week by Secretary Baker that the 401(k) capital accumulation plan in the private sector be eliminated.

Mr. Chairman, I noted your concern today over Secretary Baker's suggestion during questioning of the previous speaker.

We also favor maintaining the high 3 rather than the high 5 wage base in the defined benefit formula so as not to undermine the current retirement program.

The defined benefit plan, as proposed, would be totally financed by the agencies. We favor an employee contribution, as well, that would maintain parity between the new hires and other employees.

Another problem of the funding proposal is that the cost to the Postal Service could be excessive. A contribution from USPS should be specified that will not exceed a financially acceptable level.

The disability and survivor benefits proposed need several improvements.

S. 1527 will allow employees now covered by civil service retirement to opt into the supplemental and Social Security. We are troubled by this proposal and feel that no election period should be allowed until considerable analysis of the possible problems it might create has been completed.

The proposed CAP would permit employee funds to be invested in a broad range of securities. We favor limiting the investment to Government or Government-guarantee securities to better protect the employee's assets and to avoid some serious political and administrative problems.

I would like to submit a complete discussion of these issues and APWU's recommendations for the hearing record.

Thank you again for inviting me to present the views of the American Postal Workers Union on this legislation. The union stands ready to work closely with the committee to formulate a good and a fair plan. Thank you.

Senator STEVENS. Thank you very much, Mr. Biller. If you want to proceed next, Mr. Blaylock, we will then have questions at the end.

Mr. BLAYLOCK. Thank you, Mr. Chairman. I have with me today my national vice president from the eighth district, Mr. Miller, on my immediate left and our economist, Arne Anderson, who has been working with your staff and members of the committee on this very important issue.

Senator STEVENS. Are you still on the payroll?

Mr. ANDERSON. At this time, at this time.

Mr. BLAYLOCK. Sure.

On behalf of the 750,000 Federal workers and the District of Columbia workers that we represent, Mr. Chairman, I would like to express our appreciation to the committee for the manner in which you have approached a very important subject that is important to the long-term career service and is important to a lot of the future Federal workers.

We have covered a lot of ground since we first started this issue a couple or 3 years ago. There have been a lot of changes and a lot of improvements. We have identified collectively a lot of problems, and we found solutions on problems. And I do congratulate both you and your staff and the committee for the way you are going about this thing. I think before it is all over, we will have resolved the problems and will move on with a continuing ability to build career service.

There has been a lot of agreement reached in this process. I would like, Mr. Chairman, to submit my complete statement for the record. I don't have to tell anybody in this room it is a complicated subject, but I would like to work from about a nine-page oral statement that pretty much summarizes our position in the comprehensive statement.

As I already pointed out, there has been a lot of agreement reached gradually on the different elements of building a new supplemental retirement plan for the Federal workers that come on the payroll after January 1, 1984. However, these points of agreements should not obscure the fundamental differences which still remain. Our major disagreement with the plan stems from a fundamental disagreement over the objectives upon which the plan rests.

Nowhere in the bill's purposes and likewise, nowhere in the body, is there a clear recognition of the personnel role the retirement plan plays in fostering an experienced career work force, nor a solid commitment to it. Nowhere in the bill's purpose, nor in its body, is there a commitment to equity between the current and future employees. And nowhere in the purposes, nor in the body of the bill, is there a clear recognition of the role that retirement plans play in our society and a commitment to economic security for the retired, the disabled, and to surviving spouses and children of deceased workers.

Consequently, the plan, as designed, provides inadequate benefits. The benefits which are provided favor the short-term, higher paid managers at the expense of the majority of the Federal work force, the career Federal employee. In some ways, this plan can be interpreted as a plan tailormade for political appointees.

Perhaps this is understandable. There has been much written and considerable concern expressed by knowledgeable experts on Federal management regarding the brain drain in Federal service and the Government's inability to recruit and retain the best and the brightest into the managerial ranks. This bill would seem to try to address this problem by creating a retirement plan that is most attractive to the highest paid professionals or executives. The retirement system of the U.S. Government should not be distorted by attempting to make it a recruitment tool for a small percentage of the total work force.

Virtually all employers recognize the value of a stable, experienced, and dedicated work force. Congress clearly recognized this objective when it designed the current civil service retirement system by designing the plan to encourage persons to establish a career in the Government service.

To now design a plan which favors short-term, higher paid employees is a radical departure from this basic objective.

If Congress is to establish a just retirement system for new Federal employees, it must reinforce these three objectives. One, to promote equity between the employees; two, to give incentives for a career work force; and three, to ensure economic security for the majority of the work force, those employees in the lower and middle salary ranges.

We have long held that the existing employer cost to the civil service retirement system, which is about 24.7 percent of payroll, should be the employer cost of the new system. A plan which costs 20.8 percent of payroll cannot meet the major objectives of a just retirement plan for Federal employees and their employer.

We urge this committee to invest as much in the future employees as the Government has seen fit to invest in employees of the past. To do otherwise does not make good business sense.

AFGE supports the concept of the three-tier plan, but because we are of the opinion that the long-term career employees in the middle and lower salary brackets dominate the work force, we believe an adequate amount should be spent first to provide for a strong defined benefit component, and then on a smaller scale for the capital accumulation plan. Other mechanisms which will shift benefits to the long-term career employee should be introduced.

The present system utilizes a salary base of averaging the highest 3 years of salary multiplied by 1.5 percent of the first 5 years of service, 1.75 percent for years 6 through 10, and 2 percent for all years over 10.

We support a similar seniority-weighted accrual rate because it benefits long-term employees.

On eligibility, we believe and recommend that employees should be permitted to retire without a penalty at age 55 with 30 years of service. AFGE has consistently advocated special positions for firefighters, law enforcement officers, and air traffic controllers. The bill does have a special eligibility provision, but the definition of these employees is narrower than that which presently exists. The proposed penalties for the statutorily earlier retirement age appear unduly harsh. In addition, National Guard technicians and military Reserve technicians also require special provisions. National Guard technician should be specifically referenced in the definition of military Reserve technician.

While the bill addresses some of the disability concerns of these employees, it does not address the problem of selection out and mandatory retirements at age 60. We believe and recommend that all employees, permanent, temporary, part time, and intermittent in career condition, should be governed by this plan, and that the D.C. employees should be covered until such time as the expiration of their current collective-bargaining agreements, wherein they will have an opportunity to negotiate their own plan.

On funding, AFGE contends that old and new employees, high- and low-salaried employees should be treated as equal, if possible, under the old and new retirement systems. Therefore, we recommend the new plan require a level of contribution from which the required Social Security contribution will be made first and the balance utilized upon the basic plan and increased benefits. Contributions should be matched by agency contributions made from their appropriations. The balance of the annual cost should be paid by way of a direct transfer from U.S. general funds to civil service retirement funds.

On the replacement rate, AFGE believes a strong basic plan is essential to meet the retirement needs of the majority of the workers. Therefore, we believe the replacement rate should be high. Obviously, this would increase the cost of the proposed plan, which is estimated to be 20.8 percent of payroll.

We contend that if the Government continued to pay for the new system what it pays for the present system, 24.7 percent of payroll, then the replacement rate would be improved. A higher replacement rate could also be achieved by making certain changes in the basic plan design.

On COLA, we recognize that the cost-of-living adjustment featured in the present CSRS is the most expensive component of the plan. Therefore, we are willing to explore alternatives, particularly if the result would be to strengthen the basic benefit plan. In any event, the COLA should be linked to that provided to Social Security recipients.

The capital accumulation plan. This proposal is very generous. However, such a plan favors higher paid, short-term employees. Therefore, this provision is not consistent with the goal of designing a plan for long-term career employees, the majority of whom are in the middle and lower salary brackets. For this reason, AFGE supports a smaller thrift plan and a longer vesting for the Government's contribution with the cost savings used to enrich the defined benefit component of the plan.

The formula most commonly utilized in the private sector of 50 percent match up to 6 percent of payroll would achieve this goal.

The management of the capital accumulation plan. The bill proposes that the plan be managed by a board comprised of five members who are advised by an advisory committee, with specific day-to-day operations to be supervised by an executive director. This three-tiered structure would not be necessary if the board was composed of representative employees and money is being invested in experts in the investment field.

I would also point out at this point, Mr. Chairman, that we are talking about a large amount of money—and I'm not sure that enough attention has been given to the large amount of money that is going to accumulate in this capital accumulation plan.

I think the public has an interest here. I think we should think seriously about public representatives involved in developing investment policies of this particular fund.

On investment policy, we commend the committee for attempting to provide employees with the investment choices and for attempting to ensure that investment can be neutrally handled. However, as a general premise, it is our opinion that strict fiduciary standards should be initiated under ERISA as well as a directive to address social issues investment objectives. In the investment options, the stock funds and compilation of index and essentially all listed stocks do not take into account factors such as companies currently involved in bankruptcy proceedings and so forth. It would appear a better list would be the top 500 mutual funds and their performance over the last 2 or 5 years.

In Government securities, the interest on investment in Government securities is tied to 2-year securities. This unrealistlcally lowers the employees' earnings from this source and would force them to withdraw their funds from Government securities. We urge the interest be determined from longer term securities, as is the current practice.

On fixed-income investment opportunity, again, this is an area where: One, social concerns could be addressed; two, specific guidelines for investments need to be clarified; and three, a mechanism needs to be devised which would work to avoid favoring any one company, any one market in the economy in general.

The disability benefits AFGE is of the opinion that the disability proposal in the bill is intended to adequately provide for disabled workers as it does in the present plan. We would recommend, however, that the time period for payment of disability at the rate of 60 percent of salary be increased from 1 to 2 years; more importantly, that the proposed disability benefit continue until the annuitant is eligible for an unreduced retirement benefit under Social Security or civil service, whichever is applicable.

General section 8461 of the bill, which permits unrestricted contracting-out for administration of the retirement program, should be deleted in its entirety.

The opportunity provided to pre-1984 employees to transfer to the new plan is restricted to 1 year. This is inadequate, particularly since the implementation regulations may not be completed until well into that 1-year period, and there simply is not enough time for employees to weigh their options and trade-offs. We would recommend at least a 2-year period in which pre-1984 employees could make this selection.

A major step forward in the debate over civil service retirement has been accomplished in the effort to design the system. Namely, everyone is singing from the same song book. The model was developed by the Congressional Research Service with assistance from the General Accounting Office, Congressional Budget Office and outside experts. For this reason, we urge consideration viewed of this model in the annual calculation of the dynamic normal cost of the system. Furthermore, we urge that the legislation require this cost to be the operating cost for all Government decisions, which include retirement as a factor, such as A-76 contracting out studies.

Again, Mr. Chairman, we express our appreciation to the committee and to the staff for the work that you have done on this, and we look forward to working with you and seeing it concluded.

I would be glad to answer any questions at this time.

Senator STEVENS. I thank you both very much. I have got to say at the outset, I opposed including new civil servants under social security. I really don't think that the attacks on the administration as the originator of this bill are warranted. Actually, as you know, I started this bill before the decision was made on social security, because we thought it was coming, and it did come.

Had the plan we approved 4 years ago been put into effect, it would have been a better plan than this one, there is no question about it. If this plan we have before us now is not approved, someone else will be leading the fight for it next year, because I will not lead the fight again. This is my last term in the barrel. I have made everyone aware of that. This will be the third Congress that I have tried to get this settled, and if I cannot do it, then someone else ought to take it on.

I want you all to know that I will not lead another fight for another retirement bill. I am going to do it through this 2-year period, but if I don't succeed, someone else will have to take it on.

Under the circumstances, as I see it, you have made a lot of suggestions. Some of them have a great deal of merit. But I have a basic problem with one suggestion. That is, you basically say, "Do away with the thrift concept and compare this plan to the private sector," where, if I am properly informed, the overwhelming number of plans are integrated. They are integrated with Social Security, and therefore, the pension plan is tilted more toward the higher income people in the private sector than is the more generous thrift plan under this proposal. As a consequence, that tilt makes the comparison between the pension plan in this proposal and the pension plan in the private sector very unfair.

Suppose we do away with the thrift plan? Would you support an integrated pension plan that would tilt the pension plan against the tilt that is built into the social security?

Mr. BILLER. On the first one, Mr. Chairman, I don't believe anybody here has said they were unalterably opposed to any thrift plan. The concerns continue to be the tilt, and the concerns are for the average or lower paid employee.

In the final analysis, and incidentally, we accept the social security concept. It has been done. The fight is over, that is it. We are attempting to adjust. What we are seeking is a plan that overall is going to give our employees, the new employees, no less than parity with those of us who are under the present plan.

Now, the concerns of the thrift plan are: One, that perhaps too much is taken away from the defined benefit plan and will be tilted toward people with $40,000 or more. The second one, as I said before—and I'm not trying to put anything on you—is a concern that you registered today, and understandably so, toward the administration speaking of removing 401(k) protection under its tax reform proposals, and with the tax legislation still pending, not knowing where we are going. We have registered what we believe are appropriate concerns rather than total opposition.

Senator STEVENS. I don't disagree with you, Moe. If you look at the current system, the tilt of the current civil service retirement system is far more towards the higher income employees than this bill today. There is a definite tilt under the civil service retirement system to the higher bracket employees now.

This new system is not tilted that way. That has been the criticism of this plan from other people who appeared here, that it is tilted the other way. The pension plan portion is tilted to the lower-paid employees, no question about it.

If you look at the thrift portion, it is tilted towards the higher-paid employees, mainly because it is expected that higher income employees will utilize more extensively. But it is voluntary. Again, I seriously question the estimate—I am going to have to leave for a vote—I seriously question the estimate as to the number of people who are going to participate in this plan, knowing full well that the plan gives an opportunity for loans against the thrift plan during a person's employment. I mean, you can have your cake and eat it too under this plan. You can put away up to 10 percent of your salary, which would be free of taxes, matched 5 percent by the Federal Government, free of taxes, and borrow against it during the period of your need and during your employment, and still not have to pay taxes until you retire.

I, frankly, think it goes much further than a 401(k) and is about the best system you could possibly devise for lower income employees to increase the leverage of their own salaries by virtue of a small savings. I think most of them are smart enough to figure that out.

Mr. **Blaylock**. Mr. Chairman, if I might, as far as you moving the bill this year, I think you have got total support of the Federal employee unions as far as we know. We all need to move it this year. You will have our help.

Senator **Stevens**. Good. I appreciate it. I will be right back.

Mr. **Blaylock**. Nobody that I know of, surely not at this table, has advocated eliminating the thrift portion of the proposal. It is a question of degree and how much, because you do put the higher-paid workers in conflict with the lower-paid workers and that is different from the current plan. Because here, the larger you make the thrift plan, the larger you make the employer contribution to that thrift plan; then the more you have to take away from the designed benefits. That doesn't exist in the current plan.

I think the short-term portability bothers us as much as the amount of payroll that you are putting into the thrift plan. When we look at the private sector practice, as you pointed out, and Moe did too, about 6 percent of payroll out there with 50 percent match is the norm in the private sector.

If you look at that and you transfer that difference from what is proposed in this bill, then it would definitely allow us to raise that replacement rate from about 30 percent, from those lower paid workers, to 34 percent. That is a little bit closer to when people actually retire and they think about the amount of money they are going to have to live on.

The other point that we take on that, we don't think the lower-paid Federal worker is going to be able to participate in the thrift plan, especially if our continued attack on the pay system goes on. They are just not going to be able to. The break point is going to be about $30,000. A worker who makes over $30,000 is going to be able to take advantage of it. The ones who make lower than that are not going to be able to take advantage of what we consider a very generous thrift plan.

Mr. **Biller**. Senator, I might add that under the current retirement plan, according to the figures I hear from the Congressional Research Service report, in the year 2030 an individual retiring at age 55 with 30 years of service gets 53 percent of salary. Even with inflation and making projections through the year 2030, whether the individual had earned $15,000, $30,000, $45,000, $60,000, $75,000, it would be worth the same 53 percent of that annual salary. So the present system is not tilted.

I have to repeat, nobody kicked around the thrift plan as if to say "throw the baby out the window, whatever it is."

What we are attempting to say is that: A, too much, we think, has gone out of the defined benefit, and as Mr. Blaylock pointed out, we have serious doubts as to the people in the lower categories being able to afford the voluntary contribution to the CAP.

By the way, for the record, I forgot on my right is my esteemed legislative director, Mr. Patrick Nilan, and legislative aide, Roy Braunstein.

Senator EAGLETON [presiding]. Both of you have completed your initial statements, have you?

Mr. BILLER. Yes, sir.

Mr. BLAYLOCK. Yes.

Senator EAGLETON. Good. Senator Stevens and I are doing this voting relay business.

Mr. BILLER. We understand.

Senator EAGLETON. Mr. Biller, let me ask you this: As far as you are concerned, speaking on behalf of your postal workers, the new plan must have the full 100-percent COLA, is that correct?

Mr. BILLER. We think so.

Senator EAGLETON. Cost-wise, that adds 3 percent to the Stevens figure. So if the Stevens figure is 20.8 and we go the full COLA, that has Stevens up to 23.8.

Mr. Biller, do you believe the new plan must have the same retirement age, no reduction, at age 55, 30 years of service?

Mr. BILLER. Yes, we do.

Senator EAGLETON. That adds another 0.5, so we are up to 24.3. Now, with respect to the accrual rate, what is your position on the accrual rate? The Stevens bill is 1.0.

Mr. BILLER. Yes.

Senator EAGLETON. Do you have a position on the accrual rate?

Mr. BILLER. Yes. We would like it considerably larger.

Senator EAGLETON. Considerably higher?

Mr. BILLER. You are talking about the defined benefit, is that right? Did I misunderstand you? The 1-percent benefit?

Senator EAGLETON. Yes; the accrual rate benefit, the defined benefit.

Mr. BILLER. That is right. We would like people to be much more certain of what they can get.

Senator EAGLETON. Do you have a figure? 1.2? 1.25? 1.3?

Mr. BILLER. I would have to look at that in relation to other provisions, but I think it should be higher than the 1.3.

Senator EAGLETON. Higher than 1.3?

Mr. BILLER. Yes.

Senator EAGLETON. At the moment—we have the figures—let's stay at 1.3. That would add 3.9 to the cost. That would bring us up to 28.2. How about the disability provisions of the Stevens bill? Do you think they are satisfactory?

Mr. BILLER. There are some problems there, and we have made them in my main report. There are some technical concerns. It is a complicated issue. We have outlined our views in detail in the written testimony.

Senator EAGLETON. That whole subject matter, of course, is very complicated. I agree with you on that. But we are already at 28.2. If we add another one-tenth or two-tenths for enhanced disability, we are up to 28.3 or 28.4. Of course, we are at a veto.

Mr. BILLER. Let me only say this, Senator: I am not going to sit here and question all of those figures. I think there is room for an appropriate and decent plan of parity, and we believe, for example, that in discussing Social Security, we are not going backward, and there is no move to look looking back from the future. I am not doing that.

The realities are, we are not supportive of repealing Social Security for new hires. It is a fact now. We don't have a problem in that regard. However, what is important is we recall being told, perhaps not in this House, anyway, but there seemed to have been a general commitment that that would not adversely affect the overall supplemental retirement, and we are not looking, frankly, for a different retirement plan, but rather one of parity between the new employees coming in and those in the present plan. We think it is divisive not to have parity. We don't think it is good for either the Postal Service or for the Federal employee or for any employer. That is really what we are seeking.

Senator EAGLETON. We are certain there is going to be some difference. It is absolutely certain there is going to be some difference, because old employees are not under Social Security; new employees are. To that extent, there is going to be a difference.

You have got two workers, side-by-side at a desk or on a postal route or whatever. One is an old employee who has been there before 1984. The other one is a new hire since 1984. To a certain extent, since one is in Social Security and one is not, there is going to be that difference.

Mr. BILLER. Absolutely. There will be variations. What we are discussing is the overall concept.

For example, right now, you are starting over with a 5 percent capital accumulation plan. I don't have actuarial figures with me, but overall, we are told that costs 3 percent of payrol. If you cut that 3 percent down and put that into defined benefits, I think there are ways of working this around. I don't think I have to assume that we have come in for ideas. During a time when we get through all of this, we hope we will be able to come up with a comprehensive plan that will be satisfactory to everybody. We are not looking for any pennies more, nor do we want any pennies less. We do understand that there will be variations, particularly with Social Security rates changing and so on.

But if, overall, our people can look at it and say, "Hey, we ain't doing any worse than those people who are here now," or the other way around, I think that is good for everybody.

Senator EAGLETON. Do you have a specific modification to recommend with respect to the CAP plan? For instance, here is one. We pumped a lot of these into a computer. Here is one, 50 cents for every dollar up to 3 percent of salary.

Mr. BILLER. I would say we will give you one, OK. We will give you one.

Senator EAGLETON. That one that I just mentioned cut the cost back to 2.2. That is one of various alternatives that we have pumped into the computer and would cut back the most, and we have all kinds of variations.

Mr. BILLER. Just a question on that. Do I misunderstand it? Would it not appear presently, as was stated earlier, that if the administration stands by its proposed change in tax reform and the Congress does move out of the 401(k), would not that have the same effect on our capital accumulation plan?

Senator EAGLETON. Quite obviously, if the administration and the Congress——

Mr. BILLER. And the Congress, that is correct.

Senator EAGLETON [continuing]. Move out of the 401(k), it will have an impact on what we are doing here.

Mr. BILLER. So you can recognize our concerns at this time, too, when we don't know whether or not tax reform is going to eliminate 401(k) capital accumulation plans. We would have come up with something and then would have the heart cut out of it. We have seen that in the health plans, too, you know.

Senator EAGLETON. Yes.

Mr. BILLER. We will give you something on that CAP.

Senator EAGLETON. You will give us something on the CAP plan that is fair and equitable, and you would like to have that?

Mr. BILLER. Yes.

[The information referred to follows:]

ALTERNATIVE CAPITAL ACCUMULATION PLAN (CAP)

APWU favors a defined benefit supplemental that, in combination with Social Security, provides a total benefit at least equal to that available from the current Civil Service Retirement System (CSRS) for the employee with average or below-average pay. The main role of the CAP should be to give highly paid employees an opportunity to offset the lower wage replacement rate available to them from Social Security. The CAP will, of course, benefit all who choose to participate, but the deferred taxation on contributions and investment earnings makes it much more valuable to the highly paid employees. This group will also have greater disposable incomes from which to make CAP contributions.

Since we view the proper role of the CAP as being more limited than that envisioned in S. 1527 as introduced, we propose less federal matching. The federal government should match employee contributions at 50 cents on the dollar up to 5 percent of salary, a matching rate comparable to or better than that used in over one third of private sector plans. Employees should be able to make unmatched contributions on a tax-deferred basis up to the limits this Congress determines for 401(k) plans in the pending tax reform legislation.

The employer share of the Stevens-Roth plan totals 20.8 percent of payroll, which includes 11.7 percent for the defined benefit, 5.9 percent for Social Security, 0.2 percent for life insurance, and 3.0 percent for the CAP. A major advantage of the lower matching for the CAP is that it frees up resources that can be used for needed improvements in the defined benefit. We propose that the cost of the supplemental plan be 7.1 percentage points greater than the 11.7 percent of payroll estimated for S. 1527. The funding sources for this cost increase are as follows:

Reduced matching for CAP	1.8
Mandatory employee contribution equal to that for CSRS	1.1
Parity with employer cost of CSRS	4.2
Total	7.1

Based on the analysis conducted by the Congressional Research Service (CRS), this additional funding, equal to 7.1 percent of pay, can be used to cover the costs of the following improvements in the defined benefit supplemental:

Full COLA	3.0
Unreduced age-55 benefit	0.5
Benefit accrual rate of 1.17*	2.0
High-3 salary base	0.9
Improved disability and survivor benefits	0.7
Total	7.1

These changes to S. 1527 are summarized in the attached table, which shows CRS estimates of employee and employer costs for CSRS, S. 1527, and a modified version of S. 1527.

In summary, the type of defined benefit system APWU regards as necessary is within reach if three principles are followed: (1) parity with CSRS in cost to employer (25.0 percent of pay); (2) parity in employee contributions; and (3) a CAP that is more in line with private-sector practice.

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*--An accrual rate of 1.17 percent of average salary times years of service will supplement Social Security up to the current CSRS benefit level for an age-62 retiree with 30 years of service. APWU prefers that this accrual rate be attained through a backloaded formula that rewards the long-term employee.

Comparison of Entry Age Normal Cost Estimates
of Current CSRS to Stevens-Roth Plan As Introduced and with Suggested Changes

(estimates expressed as percent of payroll)

	Current CSRS (baseline)			Stevens-Roth Plan as Introduced			Stevens-Roth Plan With Suggested Changes		
	Employer share	Employee share	Total	Employer share	Employee share	Total	Employer share	Employee share	Total
Defined Benefit Plan	25.0%	7.0%	32.0%	11.7%	—	11.7%	17.7%	1.1%	18.8%
Social Security	—	—	—	5.9	5.9	11.8	5.9	5.9	11.8
FEGLI Change	—	0.2	—	0.2	—	0.2	0.2	—	0.2
Capital Accumulation Plan (voluntary)	—	—	—	3.0	3.0	6.0	1.2	2.4	3.6
Full Cost	25.0	7.2	32.2	20.8	8.9	29.7	25.0	9.4	34.4

Source: Congressional Research Service estimates prepared for Senate Committee on Governmental Affairs.

Senator EAGLETON. Let me switch to Mr. Blaylock here. Mr. Blaylock, is it your position that the COLA should be 100 percent?

Mr. BLAYLOCK. Mr. Chairman, as we pointed out in our testimony, we recognize that the COLA is one of the most expensive components. We also recognize, though, that the COLA was initiated to help people living on a fixed income during periods of high inflation. We recognize that this employer, the Government, and their policy generally is the leading cause of the inflationary problem because whatever happens in the country economically, the Government finally has to take responsibility for the policy of generating that situation.

But we have pointed out in our testimony, and in talking with your staff and other staff on the committee, we think that is an area where we remain flexible. We don't have final answers, but we are flexible. A basic position with the AFL–CIO is that all COLA's should be the same. Most COLA's do not start until age 62 under Social Security, obviously, and I think railroad COLA's, I believe, are the same. I am not sure.

So we think it is an area that could be explored and should be explored, and we are willing to explore that area.

Senator EAGLETON. OK. What about the no reduction at age 55 with 30 years of service?

Mr. BLAYLOCK. As an example, the previous statement I just made. If there was a half COLA between 55 and 62—and you probably have the numbers right there in front of you—that would provide enough money to pay for an unreduced benefit retirement at age 55. If that be the situation and that proved to be true, then we are very much interested in discussing that idea.

But we are basically supporting and urging that we go with a 55-year retirement with an unreduced pension.

Senator EAGLETON. A half COLA before 62 with full COLA after 62. That adds 2.5 to the Stevens cost as opposed to the full COLA, which would add 3.0. It saves, in essence, 0.5 in contrast to the 2.

Do you folks have a recommendation on the CAP plan?

Mr. BLAYLOCK. Yes, sir; we will settle on the norm in the private sector, which is a 50-percent match, 6 percent of payroll.

Senator EAGLETON. Fifty percent up to 6?

Mr. BLAYLOCK. Right.

Senator EAGLETON. That would take off 1.6. That would reduce the cost 1.6 from the Stevens level.

What about the disability benefits, Mr. Blaylock? How do they read to you?

Mr. BLAYLOCK. I believe, Mr. Chairman, that we have basically accepted the disability provisions. There was one point in there, and I don't find it right now. We had one concern, but I think basically, in concept, we have accepted that.

Let me check this a moment. On the disability benefit, we pointed out that we would propose that the disability benefit continue until the annuitant is eligible for an unreduced benefit under Social Security or civil service retirement. That was the one point we had to make. I think as it is presently written, the time period for payment of disability at the rate of 60 percent of salary be increased from 1 to 2 years, and more importantly, we propose that the disability benefit continue until the annuitant is eligible for an unreduced retirement under Social Security or civil service retirement.

Senator EAGLETON. That is page 18 of your full statement. Thank you.

Mr. BLAYLOCK. Yes, sir; I also mentioned it before.

Senator EAGLETON. Well, I am right in that?

Mr. BLAYLOCK. Yes, sir.

Senator EAGLETON. Mr. Biller, do you think that there ought to be what is sometimes termed as level contributions? That is, to set the backdrop for it so that we can all follow it, under the present civil service system, an employee pays in 7 percent of salary plus he pays in 1.3 percent for Medicare.

Mr. BILLER. That is correct.

Senator EAGLETON. So out of his pocket comes a total of 8.3. Under the Stevens bill, it is 7.0. All the employee pays in is Social Security, 7.1, and he pays in no more.

Do you think there ought to be level contributions? That is, should the new employees pay in another 1.3?

Mr. BILLER. We would look at that, yes.

Senator EAGLETON. How about you, Mr. Blaylock?

Mr. BLAYLOCK. Yes, sir; we advocate that in our testimony. That other 1.3 percent would be used, obviously, to help finance the total retirement package, yes, sir.

Senator EAGLETON. This surprises me a bit. I think in my years here, this is the first time I have heard representatives of the employee groups advocating that their members pay more out of their pocket.

Mr. BILLER. The point is that we are seeking equitable treatment for both sides, and if it means that the new people would feel shortchanged, even though they would have to pay something out, we think they would approve. We are not doing it to tax them.

Senator EAGLETON. You think the new employees are going to come to you and say, "Moe, I feel shortchanged. The guy over here is paying 8.3 out of his pocket; I'm only paying 7.0 out of my pocket. Moe, I have just got to pay more."

Mr. BILLER. Well, he is going to take a look that he is getting less. That is what is far more important. These are efforts to protect him in his old age, whether it is COLA or anything else, and including the retirement at 55 and 30 years. There is a lot to be weighed there.

Senator EAGLETON. So you have to sell it to these new fellows that we are advocating should pay more and we are advocating that the Congress at least up the Stevens ante, because you are going to, we think, get more in the long run in terms of retirement benefits by so doing?

Mr. BILLER. Well, moreover, they are presently paying the 8.3. They understand that.

Senator EAGLETON. That is the old guys.

Mr. BILLER. No, no, the ones that are in since 1984 are paying the same as those covered by Social Security because Congress was wishing to prolong that.

Senator EAGLETON. You are right.

Mr. BILLER. They understand all this.

Senator EAGLETON. You are correct. In this hiatus period, they are paying.

Mr. BILLER. That is OK. All they are looking for and all they are missing is parity.

Senator EAGLETON. What are your comments?

Mr. BLAYLOCK. Mr. Chairman, I think, the same point Moe made. First, equity between the two groups. Second, we are as concerned as you and all the members of the committee about the long-term financial security of this plan, and we recognize this money contribution has to be fair. And I would say third, if I was before you at a bargaining table with full rights and the right to negotiate behind me, I might take a different position.

Senator EAGLETON. I wonder if you set up a debate of just new members, you lock the room and only admitted new members, and you had a debate between Stevens and yourself, Mr. Blaylock, and the proposition before the audience was resolved, shall the employees here present pay 7 percent out of their pocket or shall they pay 8.3 percent out of their pocket, and you take the affirmative position that it ought to be 8.3; Stevens takes the other position, it ought to be 7. If you have a vote on it, I would bet you that Stevens would win hands down amongst those new employees.

Mr. BLAYLOCK. I don't know. I would take you on on that bet because I tell you, as we traveled around the country in the last 3 years debating with our people on this whole issue—and as you know, the level of concern has been very high, probably the most controversial issue of Federal workers—time after time, we found that the groups would say that even if they had to pay more money, they wanted to know that the benefit level was going to be there and that the security of the plan was going to be there and that they could depend on it.

I am sure Moe had some of the same experiences. They didn't tell us to run up here and advocate more money, but when the bill started shaking down and the 1983 amendments passed and everybody had to pay Medicare, that is one point that is free, everybody had to pay anywhere. When we talk about financing the long-term career work force and the staff requirements for that work force, I found no opposition out there.

So I don't know. I might take you on on that bet.

Mr. BILLER. The same thing. This is the bet we would win. I believe we would win that bet. Try it, Senator. Give them overall the same benefits, parity, and let's see what they say, if you give them the choice.

Senator STEVENS. I will take the challenge.

Mr. BILLER. OK.

Senator STEVENS. If Tommy would let me interrupt—under our plan, they don't have to pay for insurance any longer. They make one 7-percent contribution, and they have insurance, Social Security, a pension plan; and with the same amount they are contributing now, they would have 3.4 percent in their thrift plan without any increased payment, because currently they are paying 1.3 for their Medicare, and they are paying an average of 0.4 for insurance.

Mr. BLAYLOCK. Currently, Senator, they have a 56-percent replacement rate, and under your proposal, they will have about a

48-percent replacement rate. That benefit level will be lower, and you know that.

Senator STEVENS. We are talking about the younger employees. I will bet they understand that if the thrift plan is invested in the private sector in stocks and bonds, it is worth more over a 20-to 30-year period than the civil service retirement compensation alone today.

Mr. BLAYLOCK. I doubt that.

Mr. BILLER. That is not so.

Senator STEVENS. It is. It is. It just depends upon the investment pattern and the business cycle ahead, but they are insured against the business cycle by virtue of the thrift plan.

Without any additional contribution out of their pockets today, they can participate in the thrift plan to the extent of 1.7 percent and the Government will match that 1.7 percent of payroll.

Now, 1.7 percent of the payroll, almost 2 percent, that would be matched by the Federal Government with almost 2 percent. That is a substantial amount of payroll. And that would go in now and be worth something 20 to 30 years from now. I think the younger people understand that.

I have gone around the country, too, and the difference is that most of the people we talk about are under the old plan.

Mr. BLAYLOCK. No; you have got about 300,000 under the new plan.

Senator STEVENS. Listen to the younger people under the new plan. They are very skeptical even of Social Security, let alone civil service retirement. They want that private sector investment, and that is where the support is going to be.

Mr. BILLER. Congress has done the job to make sure they are not skeptical of Social Security 3 years ago, so we put the plan of Social Security in order for 50 years.

Senator STEVENS. You won't find very many young people to believe that, Moe.

Mr. BILLER. No, but that is what the Congress said.

Senator STEVENS. I understand. I understand it.

Senator EAGLETON When you are dealing with actuarial estimates, projecting investment figures, what-have-you, you are looking into the future. Stocks can go down, stocks can go up; costs can go down, costs can go up. More than likely, costs are going to go up, especially when you get into this health care business.

I think it is safe to estimate somewhere along the line that Congress is going to have to raise that 1.3 in the Medicare. When that year is going to come, I don't know, but I can just see the projections on Medicare. I have looked at some, and they are mind-boggling when you look out to the year 1995, 2000, even earlier.

For new employees, we are talking about a system that is going to run from now well into the 21st century. We have got an older system that is going to, by attrition, and acts of God, decline. I just wonder if it wouldn't be prudent to save that 1.3 for the members, for the participants, for that future rainy day, the rainy day that I think most certainly is going to come, as these medical bills soar and soar and Government costs in connection with that are going to rise. I wonder if we shouldn't say to the workers, "Look, we could have tapped you up to 7 plus 1.3, put you on an equal par with the old system. We decided to make it just 7.0, because we know somewhere along the line, we are going to have to tap you, maybe up to that 1.3." I don't know what the future will be, because medical costs are going through the roof. What do you say about that, Mr. Biller.

Mr. BILLER. Well, the counter is the other side of the coin when the Congress—so we make sure it isn't personalized—when the Congress decided several years ago to tack on the 1.3 to the Federal workers for Medicare. We had our own health benefit system, and we weren't complaining about our system, it covered retirees, and we thought the Congress did reasonably well until OPM began to manipulate it.

Senator EAGLETON. Do you have a comment, Mr. Blaylock?

Mr. BLAYLOCK. Well, the only comment I have, Senator, is you reach that far out in the future; God only knows what is going to be happening. Every time we think we have solved a problem, maybe we have in the short term, but long term, we don't solve it. I think a Congress and a union or unions representing the workers at that time will have to deal with that problem.

My hope is by the time we reach that point, the Congress will have dealt with one element of the Social Security program as it was intended in 1935, as you well know, and that is a national health care system for everybody, including, and I hope, Federal workers who will get the same treatment as everybody else in the country at that time.

Right now, I have a concern: One, of equity between the groups; two, we have a concern that the replacement rate as proposed by this plan will not be as high; and we are more concerned about the lower paid workers that will never be able to put any money into this thrift plan. You can project all you want about how they are going to participate, but I can tell you, workers below grades 7, and they work for the Federal Government, and nonappropriated workers or temporary or probationary workers, hell, they can't even make house payments and buy a refrigerator, let alone think about a savings plan that may, in 30 years, produce them some money.

I am not concerned about those that make over $30,000. They might be able to put a little bit aside. But our major role is to protect those that can't afford to, and the replacement rate for those workers is so low, when they wind up out of this proposal getting $500 and $700 and $800 a month to try to live on, I am concerned about those people. I would like to see that basic benefit as good as we could make it.

Mr. BILLER. Perhaps it would be good to take a quick look at the replacement rates in the CRS study, particularly pages 19 through 26. You will find that they are less, much less. As I pointed out before, under the current retirement system, you have got 53 percent all along.

Senator EAGLETON. Let me follow up on that. GAO, this morning—I wasn't here, but I heard other testimony—testified that if that 1.3 went into the thrift plan, focusing on this 1.3, it would amount to, at retirement, 12 percent of the retiree's final salary.

What about, if we are going to have this equal fee, equal payments, equity or something, why not put the 1.3 into the thrift plan?

Mr. **Biller**. Our concerns are—we are glad that we had at least some role in getting the Senate, particularly, and the Congress to look at a defined benefit plan. We are not chopping up a thrift plan. We have our concerns, and people who come into Government come in also for a sense of security, and we believe that they believe they would like to know what is down the pike 30 years from then in having better benefits in a defined plan. If they can afford a thrift plan, they would add to it.

Senator **Eagleton**. You haven't answered my question. What about putting the 1.3 percent for the new workers—that is the extra amount to make them level with the old workers—what about putting it in the thrift plan? They know they have got the thrift plan.

Mr. **Biller**. I understand what you are saying. We would have to look and see what that gives them. I am not an actuary, and I am not being sarcastic.

Senator **Eagleton**. Would you take a look at that?

Mr. **Biller**. We will take a look at this.

[The information referred to follows:]

USE OF MANDATORY EMPLOYEE CONTRIBUTIONS

During the hearings on S.1527, Senator Eagleton argued that employees would receive a better deal if a mandatory contribution of 1.3 percent of pay were invested in the capital accumulation plan (CAP) instead of being used to fund a better defined benefit supplemental. This conclusion was drawn by comparing a computation made by the General Accounting Office (GAO) of what the contribution would buy in the CAP with estimates by the Congressional Research Service (CRS) of the cost of various defined benefit plan improvements. However, the comparison was wrongly made, as explained below. A correct comparison of the two estimates shows that there is little difference in the worth of the two alternate uses of the contributions.

GAO estimated that a 1.3-percent employee contribution to the CAP for 30 years will generate a retirement income worth 12 percent of final salary at time of retirement. This calculation is based on three assumptions that make a comparison to the CRS figures on defined benefit improvements invalid. These assumptions are:

(1) That the employee contribution is matched dollar for dollar, thus turning the comparison into a 2.6-percent CAP contribution vs. a 1.3-percent defined benefit improvement;

(2) That the funds will be invested in savings bonds paying 7.5 percent, a return that is available today but is much too high relative to inflation to be sustainable over the long run and is inconsistent with interest rate assumptions underlying the CRS estimates;

(3) That the retiree uses the CAP funds to buy a fixed annuity, which will decline in real value each year, whereas a defined benefit improvement will be partially indexed for inflation (by CPI minus 2) under S.1527.

The comparison can be put on a proper basis by disallowing the federal match, using an appropriate real interest rate, and taking inflation into account. Making these adjustments results in the following:

	Increase in wage replacement after 30 years' service if 1.3% contributed to:		
	CAP		Defined Benefit
Step 1: Unadjusted GAO & CRS estimates	12.0		3.25
Step 2: Disallow federal match for purposes of comparison	6.0		3.25
Step 3: Use historically valid real interest rate for long-term government bonds(0.8%) instead of 3.5%	3.75		3.25
Step 4: Adjust to real values for 4% annual inflation over 20 years	3.75	(at age 62)	3.25
	1.7	(at age 82)	2.2

After adjustment, this retiree would be a little better off under the CAP at age 62 but a little better off under the defined benefit supplemental at age 82. Thus, the decision on where to put a 1.3-percent employee contribution comes down to a judgment on which return is the more dependable rather than which one is higher at age 62. APWU members feel more comfortable relying on a statutory entitlement than on an expectation of investment performance.

Mr. **Biller**. Let's get one thing clear here, and I think we have said it before. Nobody is here to rake up old coals. The unions are just as anxious to get a supplemental plan in place this year, we hope, as the Congress is, because the realities are whether it is today, tomorrow or next year, it has got to be dealt with. And surely, we are not interested in prolonging the agony for anybody. We are here to work with the Congress of the United States to try to get something satisfactory.

Senator **Eagleton**. I agree with that, and I appreciate it, and I know that is the fact.

Mr. Blaylock, what is your answer? What about if we put the 1.3 into the thrift plan?

Mr. **Blaylock**. Senator, I don't know that we would necessarily object to that. I think we are open for discussions on it.

The only negative that comes to my mind immediately, and again, our concern, is that the portability of the thrift plan accommodates the short-term worker and whether or not we want to design into a retirement system provisions that actually encourage rapid turnover of the work force. It is an area that we are hoping to explore, and we just have not explored it.

Senator **Eagleton**. I hope you will explore it. I can vividly recall hearings in a different context and in a different committee, Labor and Public Welfare, and union organization after union organization came in front of our committee and embraced portability; said that portability was an absolute necessity in today's modern industrialized world. You could move from city to city, job to job, place to place, et cetera, et cetera, and I thought it was a plank in the AFL-CIO annual statement back at that point in time. Senator Javits was on the committee working on various kinds of reforms on pension security legislation, and portability was a sacred word; somebody would have something he or she could take with him from one job to another. We had all kinds of statistics. How many times did people change jobs in their lifetime? I can't remember. That was many years ago.

Why suddenly has this portability become unsacred?

Mr. **Blaylock**. I don't know about that, Senator, but when we asked you to look at the overall objective of building a Federal plan for the Federal service, I would just ask you, do you think setting up a system that encourages turnover in the work force at a very rapid rate is in the best interests of a good career system? I guess we can debate either side of that issue.

Senator **Eagleton**. I think setting up a system——

Mr. **Blaylock**. We have a responsible concern for the long-term service for the American public.

Senator **Eagleton**. If a person worked as a secretary in the civil service system, worked diligently, effectively, et cetera, worked 10 years, then got a better job offer with with private industry and worked 20 years, I think 10 years with the civil service system ought to count for something.

Mr. **Blaylock**. I would totally agree with your example, but the bill allows them to take that money after 1 year.

Senator **Eagleton**. We can start at 10 and go to 9, go to 8, and get to 1 year and say that is hit and run.

Mr. BLAYLOCK. The example you use, I would agree with you 100 percent.

Senator EAGLETON. All right. Would you all consider the notion or the concept of putting the 1.3 in the thrift plan? Mr. Biller said they would take a look at it.

Mr. BLAYLOCK. Oh, yes.

Mr. BILLER. I will take a look at it.

Senator EAGLETON. I am not trying to tie you up on it today.

Mr. BILLER. A number of questions you ask appear in my complete testimony. However, we are going to respond to every one of them specifically anyway.

Senator EAGLETON. Thank you.

Mr. BILLER. Thank you.

Senator STEVENS. We would like to try to get the bill before the committee by the first of next month, if we can—by the end of September or the first of the next month.

Just for the guidance of other witnesses, this hearing has gone on longer than we anticipated. It is not anyone's fault but is because of the problems on the floor. We will pick up the balance of the witnesses in the morning, when we start, in SD-342. If anyone has problems and needs to reschedule, let us know.

Senator EAGLETON. Does anybody have a travel problem, anybody that we are putting off today?

Mr. BILLER. We hope there are good things going on in the Congress with the relay system.

Senator STEVENS. Let me just ask you one last question. The Social Security age was just raised. GAO has found that the Government plan, the existing one, was excessively costly in terms of age 55 and a full COLA. Private industry doesn't have automatic COLA's at all. We are comparing systems here. We are proceeding in a climate which you yourself mentioned where we have got affects from the right, very heavily affects from the right.

How are we going to get together on a system that you all are going to support by the end of the month?

Mr. BILLER. You know, you are talking about the private sector as if it is sacrosanct, but the private sector has an awful lot of freedom and, invariably, will account for cost-of-living adjustments anyway, just by doing it.

We are here bound by a law. As you know, we started out with a kicker. That was wiped out. It came down to twice a year, whatever it is. It is reduced all along the way.

Senator STEVENS. The kicker was quite similar to what we have here. When it got to be 3 percent, you got a cost-of-living allowance, plus you got 1 percent extra.

Mr. BILLER. We are not looking to beat the Government, but we are not looking to fall prey to the right-wing all the way, and I am sure you are not, either.

Senator STEVENS. Under the political climate that exists today, the proposal that I have in will have tough sledding in the Senate even with your support. We will have a tough time getting this bill through the Senate, even with your full support, because of its budgetary impact.

Mr. Grace has been very open about his objections to it, as have others. You heard the chamber's testimony. I would invite you to read it in full.

Mr. **Biller**. Mr. Grace, if I may—and I'm not here for debate or colloquy—he ought to be a little concerned about the $400 million pollution dumps he left up in Buffalo. He ought to be concerned about being a tax welfare client and all of those things, instead of running away from it and riding around the country not giving factual information.

So we are not going to be moved by the right-wing. We have a concern, of course.

Senator **Stevens**. You may not be, but some people on the floor are. As a practical problem, again, I hope that you will have some people who will listen to this testimony in the next couple of days and that we can find the time to work this out. I am talking about coming together within the next 10 days to 2 weeks on a proposal we can submit to the committee.

Otherwise, this legislation is doomed for this year.

Mr. **Biller**. We do appreciate your efforts, and it is not to butter you up. We have said that publicly.

Senator **Stevens**. I understand, and you are my great friends, and I appreciate that.

Mr. **Biller**. We are your friend, too, but we are not going to let the right-wing move you off either, Senator.

Senator **Stevens**. No; but we are still far apart. We are still far apart in terms of trying to get a bill that we can mark up. I am more than willing to consider a percentage reduction in the matching, if that is required. I will tell you what: I don't think anybody is going to end up by putting it on the pension plan, though, in the long run. It will come off.

In the long run, the amount we take out of that will not stay hooked onto the pension portion. I do think that at present we show too low an estimate of the participation rate in the thrift plan. Where is that book? Prudential estimates almost 75 percent of the people who earn under $15,000 contribute and participate in private sector thrift plans. Did you know that? 75 percent?

Mr. **Blaylock**. In most cases, that is all they have available, too.

Senator **Stevens**. And their average participation rate is 7.7 percent at all income levels compared to 8.4 percent for those who are who are earning $30,000 to $50,000. Those who earned less than $15,000, 7; those who earned between $30,000 and $50,000, 8.4. The difference is only 1.4 percent in terms of contribution. The participation rate increase is much higher in the $30,000 to $50,000 bracket, up to 96 percent. CRS has costed this thrift plan at only 3 percent of payroll. I think it approaches 5 percent.

Mr. **Biller**. Senator, we took a survey—and we will make it available—for the House Ways and Means Committee in terms of the tax reform, and our tax survey shows that the lowest salary postal workers don't contribute to IRA's.

[The information referred to follows:]

PARTICIPATION IN RETIREMENT SAVINGS PLANS

Senator Stevens argues that lower-salary workers will benefit from the Capital Accumulation Plan (CAP) in the same proportions as their higher-salary coworkers. During the hearings on S.1527, the Senator cited a study by the Prudential Asset Management Company which indicated "almost 75 percent of the people who receive under $15,000 contribute and participate in private salary thrift plans."

The APWU does not believe that the proportion of postal workers who would contribute to the CAP would be this high. We have come to this conclusion on the basis of several sources of information. The first is a July 1985 survey of APWU members which reveals the IRA participation rate by income. Because the IRA is a tax-deferred retirement savings plan, it is reasonable to use this survey information to estimate a lower bound on the CAP participation rate.

APWU arranged for a survey of 750 union members to identify their tax filing characteristics. One of the items in the survey questioned whether the APWU member contributed to an IRA from 1984 earnings. 1/ The results of the survey indicate that only 36 percent of all APWU members contributed to an IRA in 1984. The results also revealed that IRA participation was directly related to income; only 12 percent of postal workers earning less than $10,000 contributed to an IRA, whereas 63 percent of postal workers with a combined family income of $50,000 or more contributed to an IRA. The table below provides the rate of participation by income for postal worker families. It is clear that IRA participation at all income levels, and particularly below $50,000, is significantly less than the 75-percent thrift plan participation rate cited by Senator Stevens.

Percent of APWU Members with IRAs by Family Income

All Members	Up to $10,000	$10,000-$19,999	$20,000-$29,999	$30,000-$39,999	$40,000-$49,999	$50,000 & Up
36%	12%	23%	37%	40%	47%	63%

1/ The survey was a telephone survey of a randomly selected sample of APWU members. The survey was conducted by Market Facts Inc. during July 1985.

Another survey by the Employee Benefit Research Institute (EBRI) found 39 percent of eligible workers participated in a 401(k) plan. 2/ This study also found that employee participation was related to the income of the employee. For individuals earning less than $10,000, the participation rate was 20 percent, while for individuals earning $50,000 and over the participation rate was 59 percent. In contrast to the information cited by Senator Stevens, EBRI found that only 25 percent of the eligible individuals earning under $15,000 made contributions to a 401(k) plan. Again this figure is considerably lower than the numbers cited by Senator Stevens.

What the two studies indicate is that income is a significant factor in tax-deferred retirement savings plans. Although the employer's matching contribution rate may be a significant factor in increasing the participation rates of lower-income employees, the APWU does not believe that the 100-percent matching of the supplemental plan will increase participation by 50 percentage points.

2/ The Employee Benefit Research Institute tabulation of results of a joint EBRI and HHS Current Population Survey Pension Supplement prepared May 1983.

Senator **Stevens**. This is not an IRA.

Mr. **Biller**. I understand.

Senator **Stevens**. This is the means to increase your income by virtue of savings.

Mr. **Biller**. I understand.

Senator **Stevens**. On a deferred basis.

Mr. **Biller**. I understand. I do understand.

Mr. **Blaylock**. Senator, I hope that all of your projections about all the workers being able to participate in a thrift plan and voluntarily doing so, I hope they do. I am not sure at this point, though, from what we know about the lower grade Federal workers, that they will or can, and this is our concern. If you take exception to us having a concern for those workers, then I am sorry.

Senator **Stevens**. No; I am not taking exception. What I am taking exception to is the fact that you don't think we will have the money since we devised a plan that reduces their present cost from 8.7 to 7 and gives them, to start with, 1.7 percent of their payroll to contribute to a thrift plan, which would be matched by the Government with 1.7, which would give them 3.4 percent, actually increasing their retirement plan at the same cost they have today.

Our bill pays the insurance; our bill pays the medicare contribution. The maximum contribution for the new employees is 7 percent.

We built into this plan a means to fund the thrift plan for those people who are in those lower financial brackets. I don't think anyone appreciates it, but I do believe that they will participate to a greater extent than you can possibly imagine. The record shows they participate—three-fourths of them earning under $15,000 dollars in the private sector participate now.

Mr. **Blaylock**. Is that thrift all they have after their retirement in those companies that you showed me?

Senator **Stevens**. Oh, no. No; that is not so.

Mr. **Blaylock**. They have got Social Security, and they have a thrift plan retirement.

Senator **Stevens**. No; this is the whole pension. The letter is on page 200 from the Prudential Asset Management Co., and it has a whole series of different plans that they participate in, but the average contribution by an employee earning less than $15,000 is 7 percent. That is in addition to Social Security, mind you.

[The letter referred to follows:]

From "Forums on Federal Pensions," Part 5, July 10, 1984, Subcommittee on Civil Service, Post Office, and General Services, Committee on Governmental Affairs

The Prudential Asset Management Co., Inc.,
Florham Park, NJ, August 2, 1984.

Jamie Cowen,
Special Counsel, Subcommittee on Civil Service, Post Office and General Services, Washington, DC.

Dear Mr. Cowen: At the July 10, 1984 Federal Pension Policy Forum you expressed interest in the extent to which employees across all income levels participate in an employer sponsored savings and investment plan. I am pleased to furnish you with the following information concerning Prudential's savings plan for its employees. The plan is intended to meet the requirements for a qualified profit-sharing plan under Internal Revenue Code section 401(a). A copy of the booklet describing the plan is attached.

Eligible participants are employees with at least 12 months service. The plan requires that an employee contribute 3% of salary in order to participate. The Company matches 100% of that contribution. In addition, participants may contribute another 10% of their pay to the plan. The participant contributions are not tax deductible. Prudential's contributions are tax deferred compensation for the participants.

The plan enjoys an 85% participation rate among eligible employees. Moreover, contribution rates are approximately the same at all compensation levels. A full one-third of our participants at all compensation levels use the plan to save 3% of their compensation. Another one-third contribute the maximum of 13% of their compensation. The remaining participants at all compensation levels save between 4 and 12% of their compensation. The average employee saves between 7 and 9% of his compensation. The plan data, by salary brackets, follows:

	Percent
Participation rate	85
(a) participants who earn less than $15,000	74
(b) participants who earn between $15-20,000	87
(c) participants who earn between $20-30,000	92
(d) participants who earn between $30-50,000	96
(e) participants who earn over $50,000	98
Average participant contribution rate	7.7
(a) participants who earn less than $15,000	7.7
(b) participants who earn between $15-20,000	7.0
(c) participants who earn between $20-30,000	7.9
(d) participants who earn between $30-50,000	8.4
(e) participants who earn over $50,000	9.1

A number of persons at the forums expressed concerns about the possible adverse results of giving employees choices among investment accounts for their plan balances. Page 4 of the booklet describes the investment accounts. The "VCA-6" and "VCA-IF" accounts are invested primarily in common stocks. The Fixed Dollar Account guarantees the principal of an employee's plan balance placed in that account, that is, no adjustments for market value are made upon an employee's withdrawal of funds or transfer of funds from this account. Also, the Fixed Dollar Account guarantees the interest rate to be credited during each calendar year. The interest rate credited to this account for 1984 is 11.50%; for 1983 it was 11.25%. The following is a distribution of current contributions among accounts for the 1973 calendar year to the latest available date. Note that after 1974 there was a shift away from the common stock accounts toward the Fixed Dollar Account, and that after 1978 the ratio of current contributions to the Fixed Dollar Account has remained very stable at 86-87%.

PRUDENTIAL INVESTMENT PLAN EMPLOYEE (INCLUDES MAKE-UPS) AND EMPLOYER CONTRIBUTIONS

[In millions]

	Fixed dollar account		VCA–IF account		VCA–6 account		Total
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars
1984 (through March)	25.9	87	1.3	4	2.7	9	29.9
1983	100.2	87	4.8	4	10.0	9	115.0
1982	91.7	86	4.9	5	10.2	9	106.8
1981	81.2	86	4.5	5	8.9	9	94.6
1980	75.8	87	4.0	5	7.7	8	87.5
1979	75.2	86	4.3	5	8.1	9	87.6
1978	63.5	81	4.9	6	9.9	13	78.3
1977	52.8	75	5.6	8	12.0	17	70.4
1976	42.9	68	6.2	10	13.8	22	62.9
1975	30.2	56	7.2	14	16.3	30	53.7
1974	22.4	45	8.4	17	18.8	38	49.6
1973	12.6	37	6.5	19	15.1	44	34.2

I hope this information will be of use to your Committee.

Sincerely,

JAMES M. MCGRATH,
Director, Group Pension Research.

Mr. **Blaylock**. Oh, I understand that.

Senator **Stevens**. They are contributing to Social Security. Those people are contributing 14 percent of payroll to savings, and we are looking to contribute only 8.7, which is what they are currently doing, and they would have insurance, Social Security, Medicare, a thrift plan, and a noncontributed-to pension plan. I really think, you know, if you analyze what we did—I am surprised we won the battle at OMB, but we did. I hope we can get together in the next few weeks.

Mr. **Biller**. We can get together. And we are going to help you fight the radical right and the radical left. We aren't relying on a label, but we will be there. We will take care of all of them.

Senator **Stevens**. I remember what my good friend Nelson Rockefeller said, "You know, you can have the ball go down the gully on the right or go down the gully on the left, but you don't score any points. The ball has to go down the middle."

Mr. **Biller**. We want to go down the middle.

Senator **Stevens**. Thank you. We will see everyone at 10 o'clock tomorrow.

Mr. **Blaylock**. Thank you, Senator.

[Mr. Biller's prepared statement, with an attachment, and Mr. Blaylock's prepared statement follows:]

Testimony of Moe Biller, President
American Postal Workers Union, AFL-CIO

Mr. Chairman, thank you for inviting me to testify before you today on behalf of the 325,000 members of the American Postal Workers Union.

The subject of the hearing today, the design of a retirement program for postal and federal workers hired since December 31, 1983, is of fundamental importance to all our members. Enrollees in the current retirement plan are concerned because they believe that there should be comparable benefits for all employees and that the current system should not be undermined.

New employees are concerned because they should have a good retirement plan as part of their total compensation and they have been kept in the dark as to what that plan will be. "Union" means we stand together. That's why I'm here to speak on behalf of all our members.

The American Postal Workers Union supports action in this Congress on a supplemental plan. We believe it is time to end the uncertainty for the new hires. Most of this spring and summer, postal and federal employees and retirees have felt that their retirement program was in the hands of budget hijackers who were threatening, over and over, to do it harm. The completion of action on this year's budget resolution has set the hostage free--at least temporarily. Cooler heads now have an opportunity to consider this legislation without the presence of a budget gun at the head of employee benefit programs.

If a supplemental plan is not enacted, new hires will eventually have to pay the full payroll deductions for both Civil Service Retirement and Social Security. We don't want to see that happen any more than Members of Congress do. However, we will not accept a stingy, inadequate plan. It is the duty of this Committee to stand up with us and oppose the shrill demagoguery of the far right about the compensation of federal and postal employees.

Administration's Hindrance of the Legislative Process

The Reagan Administration has been no help in developing an adequate retirement plan for new hires. Mr. Devine and Mr. Grace may have high-sounding names but they took the low road on policies for public service workers. Hiding behind the mantle of authority and respectability given to them through appointment by this Administration as the former Director of the Office of Personnel Management and the former head of the President's Private Sector Survey on Cost Control, Mr. Devine and Mr. Grace continue to spread confusion and falsehoods about the Civil Service Retirement program.

One of their most commonly made charges is that an unfunded liability in Civil Service Retirement means the program is overly expensive or unsound. A recent article in the National Journal clearly demonstrated how much baloney there is in that false charge. "Red herring" is the term used in the article to describe the CSRS unfunded liability. Both Grace and Devine have been throwing into the debate on Civil Service Retirement as many red herrings as they can lay their hands on.

The former OPM Director floated a proposal a few months ago that would have meant severe reductions in the Civil Service Retirement benefit. I am glad that Congress has not given it serious consideration. It was a very unbalanced approach that ignored the three-part approach of Social Security, a defined benefit, and a thrift plan that is generally accepted as the direction to take. This Administration's input has not been constructive.

The only legislation from the Administration that has been introduced in either house of Congress is the long list of budget cuts drafted for the sole purpose of cutting the current program. These are not mainstream proposals. They are radical, right-wing and not worthy of consideration. Congress should continue to look the other way when it comes to considering this Administration's destructive proposals.

Peter Grace constitutes another arm for this Administration's attacks on federal and postal workers and retirees. The so-called Grace Commission, otherwise known as the President's Private Sector Survey on Cost Control (PPSSCC), operated between June 1982 and January 1984. Shortly after its reports were released, the quality and credibility of many of the Grace recommendations came under question.

A joint study by the non-partisan General Accounting Office and the Congressional Budget Office found that the Commission greatly overstated the cost savings attainable under its recommendations. Even without considering the merits of the proposals, the CBO-GAO review found that the savings Grace claimed were three times the level of savings actually possible. GAO further stated that it "does not find the package of PPSSCC recommendations a sound basis for restructuring Civil Service Retirement."

I am appalled that, despite these findings by non-partisan experts, he is still flying around the country with a taxpayer subsidy spreading his misinformation and sowing seeds of prejudice against public service employees.

The CBO-GAO report made an additional recommendation that the Senate Budget and Governmental Affairs Committees apparently chose to ignore this year. The report stated that changes in retirement would be "consistent and complementary" ... "if the Congress deferred action until the legislative committees acted on the changes for newly hired workers."

Despite this recommendation, some members of both the Budget Committee and this committee worked actively during this year's budget negotiations to try to use the budget process to force large cuts in Civil Service Retirement. Postal workers are thankful that, in the end, the conferees saw the wisdom of agreeing with the House position in this area.

APWU Participation in Supplemental Plan Design

The APWU has been preparing itself to participate fully in the development of a supplemental plan. That preparation dates all the way back to the first proposal by Senator Stevens for a new defined contribution plan in 1982. We opposed the Stevens proposal at that time because we felt strongly that a federal retirement system based solely on a defined contribution plan was the wrong route to go and would provide an inferior retirement plan for our members. We shared our views with the Committee even though formal hearings were not held.

Last year, this Committee sponsored a series of policy forums on Civil Service Retirement. We participated fully in each of those seminars. We were pleased with the educational process that resulted from the forums and are especially pleased with one of the main results: namely, that the Stevens/Roth legislation incorporates a defined benefit as an important, integral part of the supplemental plan.

Earlier this year, it was rumored in the press that Senator Stevens had a bill that was going to be introduced. Draft legislation was in fact circulated by staff, and we began to prepare ourselves to comment on that plan. We expected to testify in favor of certain aspects of the plan and to offer recommendations for improvement of other aspects. However, that legislation was never introduced, so we were not able to offer our reactions through testimony on its specifics. We are pleased that the process is now finally underway.

Cost of Civil Service Retirement

I want to begin my specific testimony on the Stevens/Roth bill by asking a fundamental question. Why do you want to cut Civil Service Retirement? It is a good program. We'll be the first to admit that. But it's definitely not the best in the country, and if Congress keeps chipping at it, it will get worse.

The Hay/Huggins study conducted for the House Post Office and Civil Service Committee brings out two facts that we believe are definitive in answering the question of whether the new hire supplemental program should be made better or worse than the existing retirement program.

The Hay/Huggins study looked at the cash compensation of 1,249 medium and large companies and the benefits compensation of 854 of the same organizations. It found that total average federal compensation lagged behind the average for those companies by 7.2 percent. The greatest contributing factor to this lag is federal pay, which the study found to be 10.3 percent behind the private sector.

This lag in pay was made up partially by the fact that Civil Service Retirement and other benefits are worth 2.8 percent of pay more than the average fringe benefits in the private sector. That's 2.8 percentage points above **average**. That's not overly generous, or way out of line like Peter Grace would have us believe. It's just a little above average. The retirement plan is a good plan; it should not be trimmed down every time the budget season rolls around.

Members of this Committee should be aware that, when Hay/Huggins looked at the retirement plans of the 854 companies in its study, it found that **over** 10 percent of the group had retirement benefits that were **better than Civil Service Retirement**. That means that there are at least 85 companies out there that have a better retirement program than Civil Service Retirement. Let me repeat that. There are at least 85 companies out there that have a better retirement program than Civil Service Retirement.

The federal and postal services are large organizations. They have to compete for good employees like any other organization. The Congressional budget has recommended a freeze on federal pay for 1986, so the 10.3 percent salary lag identified by Hay/Huggins will grow larger. The APWU believes that now is not the time for the Congress to make any cuts in retirement and thereby further undermine the competitive position of the federal employer.

Major Issues in the Stevens/Roth Bill

The APWU believes that the Stevens/Roth bill, S. 1527, offers a framework on which to draft a supplemental plan. However, the APWU also believes that the bill proposes a system that is inadequate in several important ways:

- The estimated cost of 20.8 percent of payroll implies that the value of the retirement plan to the employee will be one-sixth less than that of the current system. We favor a supplemental that has a total value comparable to the current Civil Service Retirement program or 25.0 percent of payroll.

- The proposed COLA of CPI minus 2 will work a serious financial hardship on retirees. For example, if you retired on a CPI minus 2 COLA and lived 20 more years--not an unrealistic expectation--the real value of your retirement pension would be one third less. A pension should be as good at age 82 as it was at age 62. COLA cuts of this type have been tried repeatedly in recent years, and all of them have ultimately been defeated. This proposal should meet the same fate.

- We cannot accept the proposal to reduce the benefit for the 30-year employee who is eligible to retire at age 55. The average employee retires at age 61. This proposal would affect only the minority who began government careers at early ages and loyally remained in their jobs. An adequate retirement after such a long career is essential to our members. Furthermore, the analysis of the Congressional Research Service shows that continued full benefits at age 55 would add little to the cost of S.1527.

- The proposed matching rate on employee contributions to the capital accumulation plan (or CAP) is far in excess of typical private sector practice. We favor less matching for the CAP. Instead, a higher accrual rate for the defined benefit supplemental should be offered so that the average worker can be assured of a decent retirement whether or not he or she has been able to put money into the CAP.

- The defined benefit plan as proposed would be totally financed by the agencies. We favor keeping the same total employee contribution that new hires now pay.

- The disability and survivor benefits proposed need several improvements to prevent situations in which those in need of these benefits would find themselves in dire straits financially.

- The proposal would allow employees now covered by Civil Service Retirement to opt into the supplemental and Social Security. We are troubled by this proposal and feel that no election period should be allowed until considerable analysis of the possible problems have been completed. Considerable testimony was presented last spring before the House committee on the problems which have been experienced when similar elections were allowed by new state retirement plans for enrollees in a former plan. Those mistakes should not be repeated in this legislation.

- The proposed CAP would permit employee funds to be invested in a broad range of securities. We favor limiting the investment to government or government-guaranteed securities to better protect the employee's assets and to avoid some serious political and administrative problems.

A complete discussion of these issues and APWU's recommendations is attached to this testimony as Appendix A.

Thank you again for inviting me to present to the Committee the American Postal Workers Union's views on this complicated but crucial legislation. The Union stands ready to work closely with the Committee to formulate a good and fair plan for recent and future federal and postal hires.

Appendix A: Comments of American Postal Workers Union on Issues Raised by Stevens-Roth Bill (S.1527)

The American Postal Workers Union supports the basic 3-part structure for the supplemental retirement plan proposed in S.1527. After reviewing the details of the plan, we have three major recommendations for change:

(1) The cost of the system should be close to that of the Civil Service Retirement system;

(2) The added cost is justified by needed improvements in the defined benefit supplement;

(3) A part of this added cost can be funded by reducing an overly generous government matching of employee savings that S.1527 proposes.

These three issue areas are discussed below.

1. Cost

The entry age normal cost of the Civil Service Retirement system has been estimated at 32.0 percent of payroll in a recent Congressional Research Service (CRS) analysis. The employees contribute 7.0 percent for this plan, with government paying the remaining 25.0 percent.

The CRS cost analysis of S.1527 shows its total cost as 29.7 percent of payroll, of which 8.9 percent is paid by the employees and 20.8 percent by government. The 8.9-percent employee share consists of 5.9 percent for the Social Security tax and an estimated 3.0-percent average contribution to a capital accumulation plan (CAP).

Using these CRS figures, we see that the average employee would pay 1.9 percentage points more under S.1527 than under the current system, an increase in retirement contributions of over one fourth. The value of the program S.1527 would establish is worth 2.3 percentage points less than the current plan, or a 7-percent cut in plan value.

This treatment of new hires would be wrong for two reasons. First, it would establish a serious inequity between the new hires and their fellow employees. Second, it is grounded in an unsupported theory that the current federal retirement program is unreasonably generous.

Retirement, together with cash wages, health insurance, and several other fringe benefits, make up the compensation package an employer offers to attract the quality and quantity of labor needed. The federal government competes with private sector employers in both national and local labor markets to hire and retain its staff. Since there is little differentiation of wages and benefits by type of employee within the U.S. Civil Service, the government's compensation package must be designed to compete in the toughest labor markets. Otherwise, the government could wind up with an adequate supply of some types of labor but fall far short of needed labor in positions that require skills in short supply.

Fortunately, an excellent study was completed last year for the House Post Office and Civil Service Committee that compares federal compensation with that in a large number of private firms. Thus, we know whether or not federal pay and benefits are out of line compared to the compensation offered by private competitors.

The study, by Hay/Huggins, compared federal compensation to the pay levels of 1,249 medium and large firms and the benefit plans of 854 firms. Comparing federal compensation to the average figures for the firms disclosed the following:

Component of Compensation	Amount Federal Compensation is Over (+)/Under (-) Average for Private Firms (Percent of Payroll)
Pay	-10.3
Retirement	+6.4
Health	-2.2
Other benefits	-1.4

A 7.2 percent increase in federal compensation would be needed to equate the federal package to that of the average firm.

This comparison shows that Civil Service Retirement is the only program keeping the federal government reasonably competitive in compensation with the average firm. However, even the retirement program lags when the comparison is drawn with only the top firms. The Hay/Huggins study found that all of the top one-tenth of the 854 firms had retirement plans that are more valuable than the federal plan as a percent of payroll.

In summary, a cheap plan for new hires will hurt government personnel policy in two ways. It will drive a wedge of inequity between employee groups based on hiring date, and it will harm the government's ability to compete for a properly skilled workforce.

2. The Defined Benefit Plan

The defined benefit supplemental proposed in S.1527 would be an add-on to Social Security for retirees. We support the general structure of the proposed plan. However, the supplement to Social Security would not be adequate for the employee with an average or below-average salary. There are a number of factors that lead us to this conclusion, which we discuss below.

a. The Benefit Formula. The proposed plan would accrue benefits at a rate of 1.0 percent of the base salary per year of service. The base salary would be the average annual salary for the highest five years. We estimate that this formula, when applied to an age-62 employee with 30 years of service, would produce a total benefit, including Social Security, that is equivalent to what the current system provides for a person earning less than $20,000. Everyone over this "breakeven" salary would be better off under the current system. We feel that this breakeven level is too low. An employee with below-average pay should not have to rely on his or her ability to save substantial sums and invest wisely to maintain the level of retirement income now provided to those hired before 1984. Also, use of the high-5 average salary instead of the current high-3 would create a difference in treatment of new hires vs. pre-1984 employees that should be avoided.

b. The COLA. The Stevens-Roth bill would limit cost-of-living adjustments (COLAs) to the annual increase in the Consumer Price Index (CPI) less two percentage points. Congress has considered such COLA reduction proposals over the past few years and has refused to approve permanent reductions. The reason for this refusal is simply that COLA reductions are bad policy. The longer a retiree lives, the smaller the real value of the benefit becomes and the lower the standard of living falls if a partial COLA is used. The supplement for a person who lives 20 years in retirement would fall by one third in real value under the "CPI minus 2" provision. This COLA reduction would work a particular hardship on those with average and below-average pay who would start out with inadequate benefits at retirement.

c. Retirement Age. S.1527 proposes a penalty (a 2 percent reduction per year) for retirement prior to age 62. It would permit retirement at age 55 with as few as 10 years of service, but with a larger penalty applied (5 percent per year). This latter liberalization of current law would provide benefit amounts that would be quite small and, thus, of little consequence to the overall system. The proposed early retirement penalty for the career employee is a serious matter, however; such a penalty would save little in plan cost and would be a disservice to career workers and to the government's workforce management.

Government needs both career employees and shorter-term workers. A solid cadre of career staff is necessary to provide agencies with the stability, institutional memory and nonpartisan staff loyalty that government administration requires. A major attraction to the government employee to make government a career has been the opportunity to take full retirement and take up other pursuits after 30 years of service and attainment of age 55. A reduction of the supplemental benefit by as much as 14 percent compared to current practice would place a major obstacle in the path of 30-year retirement for the most devoted members of the government workforce.

This penalty would lead to an older government workforce over time as some career employees delayed their retirement until such time as their benefit entitlements reached adequate levels. While later retirements can be justified based on national policy on total withdrawal from the U.S. labor force, there is no justification for delayed withdrawal from the federal government's workforce. Total government employment has changed little since the late 1960's. It is unlikely to change much over the foreseeable future. Private firms, when faced with such trends, often take steps to encourage early retirement. Such actions are needed to allow room for hiring new personnel and promoting existing employees. Failure to make such allowances will ultimately lead to a lower quality workforce and serious morale problems. The U.S. government should not follow such a course anymore than a private firm should.

d. Disability Benefits. We agree with the overall structure and benefit levels proposed for the long-term disability plan. There are two technical problems with the bill that we want to see corrected.

First, the method proposed to calculate retirement benefits when a disabled beneficiary reaches age 62 is inadequate. The high-5 salary base would be adjusted forward from time of disability to age 62 by the "CPI minus 2" formula. We favor a full CPI adjustment. Employees disabled for more than a few years would have a major erosion of their salary bases if they are not fully adjusted for inflation each year.

Second, the proposed definition of disability requires that an employee disabled more than one year must be unable to perform any federal job at the same grade level within the same commuting area. This broadening of the current-law definition should not be applied to postal workers who are subject to the labor contract negotiated with the U.S. Postal Service.

e. Survivor Benefits. The survivor benefits proposed by S.1527 would be inadequate in a number of circumstances and should be redesigned. The most serious problems are discussed below.

The bill proposes government-paid group life insurance worth two times annual salary for employees under age 35, phasing down to one times salary at age 45. This phasedown occurs too early, as people in their 40s usually need significant insurance protection. We favor carrying the higher level of protection out to a later age (e.g., to age 50).

For surviving spouses of active employees, S.1527 would authorize commencement of the annuity only when the deceased employee would have attained retirement age. We favor commencement of survivor annuities at time of death, subject to current-law policies regarding remarriage.

f. Employee Contributions. S.1527 does not require an employee contribution to the supplemental retirement plan. We favor requiring a contribution from the new hires that would be equal to the contribution required of pre-1984 employees. Such a policy would mean that new hires initially contribute 1.3 percent of salary to the defined benefit plan. This contribution rate could be lowered automatically in future years as the Social Security payroll tax rate rises in order to maintain equity between the two employee groups. We recognize that exact equality would not exist for employees with salaries above the Social Security taxable wage ceiling. However, these highly paid employees would need to make contributions to the CAP to obtain total retirement benefits comparable to those available to their counterparts under the existing system.

3. The Capital Accumulation Plan (CAP)

The CAP proposed in S.1527 is too generous and should be scaled back. The proposal also raises issues of investment policy and management that should be considered.

Generosity of CAP. S.1527 proposes that the federal government match employee contributions dollar for dollar up to 5 percent of salary. The contributions and the matching funds would be exempt from current income taxation, and employees could contribute another 5 percent of salary on a tax-deferred basis as well.

This plan would be much more generous than the typical private-sector plan. The data reported by the GAO in their 1984 study ("Features of Nonfederal Retirement Programs") showed that the most common private plan matches employee contributions at 50 cents on the dollar up to 6 percent of pay. Even among the 50 largest firms, only one third offer dollar for dollar matching.

There are two problems with this level of generosity. The first is that a deficient defined benefit plan coupled with a generous CAP would make up a retirement system that treats high-salaried employees very well but leaves the average and below-average employees worse off than they would be if under the current system. Also, it would make the variable, unpredictable portion of retirement income a rather large part of the total. For example, a 30-year, age-62 retiree who participated fully in the CAP would receive benefits in the proportions shown below according to the CRS analysis of S.1527:

	Proportion of Total Benefit by Source if Final Salary Is:			
	$15,000	$30,000	$45,000	$60,000
Social Security	33%	30%	22%	18%
Defined Benefit	39	42	45	48
CAP 28	28	30	32	34

A system that requires a $15,000 employee to depend on an ability to save regularly and on financial market performance for over a fourth of his/her retirement income is clearly unbalanced.

A second problem is that the Administration's tax policies are now directed at limiting tax-deferred saving, and Congress may decide this year to accept some of these proposals. The most stringent proposal would limit an individual's combined contributions to a 401(k) plan and an IRA to $8,000 per year. Under S.1527, this limit could be breached by anyone making at least $40,000 a year and making a maximum contribution to the CAP. (A $40,000 employee could have a total contribution of $6,000 to the CAP and $2,000 to an IRA.) It would be unwise to rest a key plan design feature on a policy that might well be changed before the CAP could be started.

Investment Policy. The bill permits individuals to choose from among several investment funds, including a fund based on a major stock market index and other funds that the CAP Board may establish. The Governmental Affairs Committee should review this policy carefully and consider as an alternative that funds be invested only in government or government guaranteed securities.

Allowing private-sector investing raises several potential problems. First, it may be politically impossible to limit the investment options to a manageable number, and the program may wind up with a large number of private vendors and inadequate oversight by the government. Second, permitting risky investments will create a greater divergence in the retirement income available to federal and postal employees and increase the chances that some employees will suffer capital losses. Third, taxpayers may resent their tax money being used for federal workers to invest on Wall Street, a resentment that would probably not arise if the funds were used instead to purchase government debt.

Management of the CAP. S.1527 proposes a Thrift Investment Board consisting of the Federal Reserve Board Chairman, the Treasury Secretary, the OPM Director, and two federal employee representatives appointed by the President, one from labor and one from management.

We believe the mix of the Board should be changed, perhaps by expanding the membership, to allow majority representation by professional investment experts. The members who are not officials should be named by the President with the advice and consent of the Senate.

4. Summary

The Stevens-Roth bill is a starting point for the Senate's debate on the supplemental retirement plan for new hires. The defined benefit portion of the system must be strengthened, however. The cost of the needed improvement can be covered by: (1) requiring employee contributions; (2) reducing the generosity of the federal matching for the CAP; and (3) accepting the notion that federal retirement benefits should not be cut below those of the present system in terms of long-run cost. These changes will yield a plan that gives the average employee the security needed in old age and gives the government the tools it needs to compete for a well-qualified workforce.

A final issue raised by S.1527 is whether to allow employees now covered by Civil Service Retirement to elect coverage under the new system. We feel that enactment of the proposed option to elect such coverage would be a mistake. Congress would have to amend the Social Security Act to allow voluntary election of coverage, and the whole issue of universal coverage may again arise. The election process itself would require complex choices by individuals who are not prepared with the information needed to make such decisions. If large numbers of employees did choose the new system, the political support for the existing system would be threatened, and the livelihood of current retirees could be placed in jeopardy. If the decision to switch corresponded with employee ages and income levels, a corrosive split between management and labor and between older and younger employees might result. Those who chose the new system might later regret their decisions should Congress change the CAP unfavorably as a result of shifts in overall tax policy. For all of these reasons, it would be foolish to write an option to switch into the new plan.

STATEMENT BY

KENNETH T. BLAYLOCK
NATIONAL PRESIDENT
AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES
(AFL-CIO)

BEFORE THE

SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE AND GENERAL SERVICES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON

S. 1527, "CIVIL SERVICE PENSION REFORM ACT OF 1985"

SEPTEMBER 9, 1985

On behalf of the 750,000 Federal and District of Columbia employees we represent, the American Federation of Government Employees, AFL-CIO, appreciates this opportunity to testify before the Senate Government Affairs Committee on S. 1527 and the design of a staff retirement plan for employees hired after December 31, 1983.

The issues surrounding the design of a new retirement plan are technical and complex. The committee members and their staffs are to be congratulated for their careful and deliberative approach and subsequent mastery of the technicalities of the issues.

Because of this process, near consensus on several major issues has been reached, including:

- The plan should be composed of three tiers; Social Security, a defined benefit component, and a Capital Accumulation Plan.
- The "add-on" approach is the preferred method of integration.
- The special job requirements of law enforcement, firefighters, National Guard technicians, and air traffic controllers require special retirement treatment.
- The existing Trust Fund arrangement should be integrated with the new plan.

Certainly much ground has been covered since the introduction of Senator Stevens' first proposal several years ago. AFGE is appreciative of the recognition of many of our concerns.

However, these points of agreement should not obscure the fundemental philosophical differences which remain.

It has always been our view that the correct and appropriate method for addressing the design of a Supplemental Retirement System was first to clearly identify the objectives of the system. Then, once the objectives were defined, to design the best possible system to fulfill those objectives.

In our view, S. 1527 attempts to do this. The objectives of the bill are plainly stated and the design clearly follows from those purposes. Thus, our major disagreement with this plan stems from a fundemental disagreement over the objectives upon which the plan rests.

Nowhere in the bill's purposes (and likewise, nowhere in the body of the bill) is there a clear recognition of the personnel role a retirement plan plays in fostering an experienced, career work force, nor a solid commitment to it. Nowhere in the bill's purposes (nor in its body) is there a commitment to equity between current and future employees. And, nowhere in the purposes (nor in the body of the bill) is there a clear recognition of the role that retirement plans play in our society, and a commitment to economic security for the retired, the disabled and to surviving spouses and children of deceased workers. Consequently, the plan, as designed, provides inadequate benefits overall. The benefits which are provided favor the short-term, higher paid managers at the expense of the majority of the Federal workforce -- the career federal employee. In some ways this plan could be interpreted as a plan tailor-made for political appointees.

Perhaps this is understandable. There has been much written and considerable concern expressed by knowledgeable experts on Federal management regarding the "brain drain" in Federal service and the government's inability to recruit and retain the best and the brightest into its managerial ranks. This bill would seem to try to address this problem by creating a retirement plan that is most attractive to the highest-paid executive or professional. Not only is this unfair to a majority of the workforce, but we do not think this will work. The retirement system of the United States government should not be distorted by attempting to make it a recruitment tool for a small percentage of the total workforce. The personnel problems of the Federal government are larger than one component of the total compensation package. Therefore, solutions must be sought in analyzing all of the components of the total compensation package.

Virtually all employers recognize the value of a stable, experienced and dedicated workforce. Congress clearly recognized this objective when it designed the Civil Service Retirement System by designing the plan to encourage persons to establish a career in the government service. To now design a plan which favors short-term, high paid employees is a radical departure from this basic objective. The Federal government with its constant political turmoil at the top of its management has a special and crucial need for such a work force to keep the basic systems of government effectively operating in a consistent manner. A retirement plan which neglects this fundemental objective -- that of weighing benefits for the long-term career employee whose salary is in the lower to middle income bracket -- is deeply flawed.

From the viewpoint of the employees, the retirement plan must be fair and equitable. This concern is especially important here. For many years to come we will be dealing with two separate retirement plans for Federal employees who, in many cases, will be working side-by-side in the same job category. Our current members in the existing Civil Service Retirement System (CSRS) are worried that the new plan will drive down the benefits in their retirement plan. This concern is particularly verified when one recalls the many statements made by Congressional members advocating universal coverage that it would not impact on the Federal Retirement System. Yet here we are, two years later drafting a new plan and faced with a general recognition that the total retirement program will offer less benefits. Our new members are asking that this new plan not be inferior. Certainly there will be differences between these two plans. But the wider the differences between them, the more unfair and the more threatening those differences will appear to be. We must seek to minimize those differences and inequities. This, in our view, must be one of the objectives in the design of the new plan.

The final test of the worth of any retirement system is whether it not only protects the workers and their families from indigence and calamity but that it provides the ability to retire with security and dignity in old age and security in the case of disability and death. In this century there has developed a social mandate that in exchange for productive labor, society and employers are obligated to provide such security and dignity, as part and parcel of fair and decent wages and as a right of citizenship. In President Roosevelt's words in his June 8, 1934, Message to Congress:

> ". . . Among our objectives, I place the security of the men, women, and children of the nation first . . .Fear and worry based on unknown danger contribute to social unrest and economic demoralization. If, as our Constitution tells us, our Federal Government was established among other things, 'to promote the general welfare,' it is our plain duty to provide for that security upon which welfare depends."

Thus began the American system of Social Security whose 50th anniversary we celebrate this year. Since then, virtually every major employer has bolstered that system with additional pensions and benefits, making the two inseparable and interdependent, a baseline for the value of labor and a floor of social insurance. The Civil Service Retirement System predates Social Security and it not only embraced the Social Security objectives but specifically recognized the Government's obligation to meet its social responsibility to provide its employees with security and dignity in their retirement.

If Congress is to establish a just retirement system for new Federal employees, it must reinforce these three objectives--to promote equity between employees, to give incentives for a career work force, and to insure economic security for the majority of the workforce -- those employees in the lower and middle salary ranges.

I. EQUITY BETWEEN CURRENT AND FUTURE EMPLOYEES

EQUITY IN BENEFITS

We have long held that the existing employer cost of the Civil Service Retirement System (about 25% of payroll) should be the employer cost of the new system. It is important to recognize the reasonableness of this number. Even with an employer cost of 25% of payroll, the current civil service retirement system (CSRS) cannot be duplicated because Social Security provides benefits which are not provided under the existing CSRS. In addition, the new plan is a diminution of the potential retirement benefits available to Federal employees because Federal workers will never again be able to draw independently from both Social Security and Civil Service Retirement. Finally, given the fact that all parties agree that a Capital Accumulation Plan (CAP), based on voluntary employee contributions will be a component of the retirement system, employees generally will be contributing a larger portion of their pay for retirement purposes than current employees in order to maintain the same amount of employer benefits.

We and our prospective new members can live with all three of these facts, which are part of the price that we pay for this new plan. But to reduce benefits further because the employer wants to cut his share of the costs would be punitive and will jeopardize the basic principle of fairness and equity. Quite frankly, a plan which costs 20.8% payroll cannot meet the major objectives of a just retirement plan for Federal employees and their employer. We urge this Committee to invest as much in the future employee as the government has seen fit to invest in employees of the past. It is only fair.

EQUITY IN CONTRIBUTIONS

When we testified before this Committee on the Federal Employees' Retirement Contribution Temporary Adjustment Act, we argued strenuously for the principle that pre and post-1984 should make equal mandatory retirement contributions. We still endorse this principle and therefore urge this Committee to adopt a provision for level contributions. From such contributions, the employees' Social Security obligations would be met and the balance could then be used to improve the defined benefit portion of the plan.

EQUITY FOR SPECIAL RETIREMENT CATEGORIES

S. 1527 severely and unwisely restricts the definition for law enforcement and firefighter personnel by limiting coverage, applying a new standard of "rigorous" work, and eliminating some positions in these occupations. In discussions with Committee staff, they explained that the current CSRS covers positions which they think do not deserve coverage and they cited as an example kitchen employees in the Bureau of Prisons (BOP). Yet BOP kitchen employees spend every day working side-by-side with hardened criminals who have access to kitchen utensils--knives and meat cleavers. Inmate attacks upon all prison personnel, not only correctional officers, have dramatically increased over the last decade. The positions are filled with danger and stress. Turnover within virtually all personnel in the BOP is at alarmingly high rates. Eliminating coverage for the full range of BOP personnel would be a very serious mistake for the government and would unfairly compensate many employees who are exposed to constant danger.

Eliminating coverage for certain managerial and office positions when "line" law enforcement officers and firefighters are promoted into those positions also makes little sense. Basically, you penalize an employee for a promotion. The government would likely lose many valuable and capable people for such positions.

Obviously, no definition for these special occupations will be perfect. If there are undeserving positions, we will work with the Committee to address these problems. However, the proposed language is a case of throwing out the baby with the bath water.

The current retirement system for these special occupations permit retirement at age 50 with 20 years' service, with mandatory retirement at age 55. It provides for increased contributions (7.5%), a higher accrual rate, and full indexation. S. 1527 calls for a normal retirement at age 55, with 25 years' service, no mandatory retirement, no contributions, an undifferentiated accrual rate, a Social Security supplement indexed by wage movement, a CPI-2 COLA, and optional participation in the thrift.

The differences are far too wide. Under the current system an employee with a final salary of $30,000 at age 50, with 20 years' service, retires with a fully indexed annuity of about $14,200. Under the new system the same employee's annuity would be only $3,450. Even at age 55, when the Social Security supplement became effective, the new employee's annuity would be only $7,450 compared to $17,298 under the existing system.

We believe that special retirement provisions for these occupations have been driven by the unique demands and requirements of these jobs. These demands and requirements have not changed and need to be accommodated in this new retirement plan. Although this plan does provide some recognition of the special nature of these occupations, we think the proposed provisions are inadequate. We urge the committee to maintain an unreduced pension (with a Social Security supplement) at age 50, with 20 years' service. We further urge that the accrual rate be bolstered for these categories to provide for an adequate replacement rate. (This could be coupled with a higher contribution rate for these employees.) Finally, we think that, for the sake of consistency, the Social Security supplement should be indexed by the Consumer Price Index rather than the Average Indexed Monthly Earnings, as proposed.

II. INCENTIVES FOR A CAREER WORK FORCE

There are many ways to define retirement benefits so as to encourage and reward long-term, career employment.

THE SIZE OF THE CAP AND THE NEED FOR INCENTIVES FOR A CAREER WORK FORCE

In reference to S.1527, perhaps foremost among these would be the weight of the CAP as it relates to the defined benefit.

The CAP, as it is proposed, favors high income and short-term employees. The risk of the poor economic performance of investments becomes a burden on the employee, one that the average employee is less able to bear.

Although we have agreed to include a CAP in the plan, we think this plan makes employees far too dependent upon it for their economic security, and because the lower and average wage-earners are least likely to use it, it will mostly benefit the highly paid. In addition, unlike the private sector norm, this plan allows vesting for employer-paid matching contributions after only one year. Clearly this is intended to benefit the short-term employee, especially the high-paid political appointee.

We do not object to this per se--if that is a benefit Congress wants to provide--but we do object to providing such a benefit at the expense of reducing the defined benefit portion of the plan which is most heavily relied on for retirement purposes by rank and file employees who, unlike the political appointee, are committed to a lifelong career in government. Since a CAP shifts the burden for a decent retirement from the employer to the employee, the defined benefit plan must be large enough to ensure economic security.

If the CAP is as large as in the proposed legislation, it threatens the adequacy of the defined benefit plan. We urge the committee to redefine the CAP, to reduce the relative weight of it--perhaps to a formula more like a 50% match up to 6% of pay. The cost savings of changing the formula should be used to bolster the defined benefit portion of the plan.

VESTING IN THE CAP AND A CAREER WORK FORCE

Another proposal to offset how the CAP favors short-term workers would be to increase the vesting period for the government's match.

The current proposal would provide partial vesting of the government's match after just one year, increasing by 20% per year until fully vested in the government's match by the end of five years. We would suggest that the government matching contribution not begin to be vested until five years, and not fully until the end of ten years of Government service.

There are many alternative vesting schedules which are feasible such as eliminating the vesting schedule and vesting the entire government's contribution at five years. The resulting cost savings should be used to bolster the defined benefit portion of the plan.

THE ACCRUAL RATE AND A CAREER WORK FORCE

The existing CSRS rewards and encourages employees to make a career of Federal service by a seniority weighted accrual rate which pays higher benefits for many years of service. The existing accrual rate is 1.5% for the first five years, 1.75% for the following five years, and 2% thereafter.

S. 1527 proposes a flat 1% accrual rate. There is no reward for long-term service.

As part of the objective to promote a career work force, we urge the Committee to adopt a seniority weighted accrual rate, such as the following:

1) .5% for the first 10 years of service
2) 1% for the next 10 years of service
3) 1.75% thereafter

With 30 years of service this would provide a replacement rate of 32.5% compared to 30% under the proposed accrual rate. This proposal would not necessarily add to the cost of the plan. In fact we believe this specific proposal does not add to the cost. And while we do not believe that a 32.5% replacement rate is adequate, this would be a move in the right direction. Indeed, as we have said elsewhere, we believe the defined benefit is not adequate and must be improved. Fundamentally that means some increase in the benefit formula. But for the sake of illustrating the issue of how a "stepped" accrual rate provides an incentive for career employees, we have suggested this "no-cost" option to the proposed bill.

III. ECONOMIC SECURITY IN RETIREMENT PLANS

COLA'S

With the onset of persistent inflation during the 60's, it became increasingly obvious that retirement programs which are solely defined without regard to inflation would fail in their goals of providing for retirement with security and dignity. Inflation cruelly punishes those on fixed incomes who have no ability to engage in paid employment. As a result, in the 60's and 70's many retirement plans, including Social Security and CSRS, began making provisions for cost-of-living adjustments.

It is also important to note that unlike any other employer, the Federal government through its fiscal and monetary policies is directly responsible for inflation. Thus, the Federal government has a unique responsibility to protect its elderly retirees from the consequences of its own action. And, it is only fair that COLA provisions between government programs designed to ensure economic security are all treated equally. For this reason, we urge the committee to reject the proposed CPI minus two and provide for a COLA for the CSRS which is the same provided to Social Security recipients.

THE RETIREMENT AGE

One of the major advances for working people in the history of this country was achieved by enactment of the Social Security program and the spread of employer pension plans. This allowed workers to retire as a reward of lifelong labor and to enjoy his or her remaining life with economic security. To penalize the long-term career employees for wanting to enjoy that reward while their health is good and they have many years to live is wrong. A penalty for early retirement is not fair in such cases. We could understand a penalty for early retirement if this benefit were very large and costly, but it is not. Under most circumstances, retirees will wait until 62 to retire so that they will receive all retirement benefits -- Social Security and CSRS because otherwise they would not have sufficient retirement income.

THE SOCIAL ROLE OF RETIREMENT AND THE PLAN'S COVERAGE

A premise upon which all parties in this debate can concur is that all employees who work for the Federal government are entitled to a retirement plan. Therefore, the proposal should specifically include intermittent or seasonal employees, temporary employees, as well as non-appropriated fund employees.

Perhaps, in the past, the exclusion of these groups could be overlooked insofar as they could be seen as unlikely to vest and unlikely to benefit from inclusion. This is no longer the case because:

1) OPM has recently pushed agencies to substitute temporary and intermittent employees for permanent employees.

2) OPM has granted agencies new authority to make and extend temporary appointments up to 4 years and longer with OPM approval.

3) Because of tightening agency budgets, agencies are abusing these powers by substituting non-covered employees for permanent employees for the sole purpose of avoiding benefit costs. The Exchange Services in DOD have been prime violators of this practice.

4) Certain agencies such as the Forest Service and Social Security have undertaken employment practices where individuals work for recurring periods over many years of time in the same position. These employees are basically permanent, intermittent employees and should be able to participate in the retirement plan.

For the above reasons, the GAO has already recommended making all Federal employees eligible for the full range of Federal compensation, including Civil Service Retirement (see GAO, Part-Time and Other Federal Employment: Compensation and Personnel Management Reforms Needed, (FPCD-78-19, June 5, 1979), and we urge the committee to include this recommendation in this bill.

SURVIVOR BENEFITS AND SOCIAL POLICY

The family as a social institution is the bedrock upon which our civilization rests. Although the family structure has undergone profound changes over the years and every so often pop-theorists predict its demise, marriage and families with children continue to demonstrate the American way of life. The family is reflected in Social Security spousal benefits; tax treatment of the two-wage earner family; poverty definitions; and virtually every public policy. As a matter of fact, public policies often turn on whether the issue is seen as pro-family for anti-family.

The survivor provisions in this bill are anti-family. By requiring an actuarial reduction, to provide a survivor benefit, most employees could not afford to retire and provide for a survivor annuity. Therefore, the economic security of the surviving spouse and children in the families is threatened. These provisions are among the most disappointing in the bill.

Take the example of the $30,000 per year employee who dies at age 50 with 30 years of service and a 45 year old spouse. First, the spouse would not be eligible for any annuity for 5 years. Obviously finding an adequate income at age 45 for a widow or widower, possibly with school-age children to support, is not a good prospect. The employee's annuity, if he was age 62, would have been $8,100. Applying the 2% penalty per year for age 55 retirement, leaves $6,960. Applying the actuarial reduction for providing the survivor annuity leaves about $6,100--the reduction would be larger if the spouse was younger. The surviving spouse would then receive half that, or $3,050, when she reached age 50, five years later. No Social Security benefits may be forthcoming until age 60, and since this survivor's benefit is not fully indexed, the survivor would be effectively diminished by inflation to about $2,600 (in constant dollars) by age 60.

While the plan would also provide a group term life insurance at no cost to the employee--and we do endorse that provision--the final benefit amount clearly is not enough to replace the loss of income felt by death of the wage-earner.

We urge the committee to:

1) Substitute a reasonable flat reduction to "purchase" the survivor's annuity instead of an actuarial reduction.

2) Provide the survivor annuity immediately and without restriction upon the death of the employee.

3) Calculate the survivor benefit on the employee's unreduced annuity.

Finally, we urge the Committee to continue benefits for children under the new survivor provisions, similar to the current CSRS. Since Social Security does provide sufficient benefits for children before age 18, we do not seek any supplement except for those between age 18 and 22 who are in full-time attendance at school. We note especially that this benefit is so small in cost that for all the security it provides to families, it is more than a thousand fold worth the investment.

IV. OTHER MAJOR ISSUES

There are two major non-design issues with which we strongly disagree. The first involves the funding mechanism. The second concerns the administration of disability program.

The bill would provide dynamic normal cost financing which would eliminate future scare mongering around the unfunded liability issue. We have no basic problems with this approach.

However, we do take strong exception to providing this financing out of agency appropriations. Forcing agencies to take this money out of salary and expense accounts would make budgetary planning much more difficult because it would crucially depend upon the ratio of current to new employees, the rate of turnover, and the transfers into the new system. Furthermore, appropriation committee members and staff would need to understand that although greater appropriations are required for a given number of employees, these greater appropriations in no way affect the deficit, but only relates to a bookkeeping innovation to account for retirement obligations as they are earned rather than finacing them by direct transfer mechanisms from the general Treasury to pay benefits as they are due.

These concepts can befuddle even the intelligent, who are well intentioned. In the hands of those with less insight and understanding or less honorable intentions, they can create intellectual chaos. In all likelihood, these analytical niceties would fall by the wayside in these years of budget crisis. Freezes on agency appropriations, where dynamic normal retirement costs were not explicitly recognized in the past, would translate unthinkingly into large personnel cuts once these costs were explicitly accounted for.

Interestingly the idea of using appropriations to fund the retirement plan is not new. Historically the Trust Fund was dependent upon annual appropriations until 1969. Its financing ran into trouble because of it. For this reason, employees do not have faith in a system dependent upon annual agency appropriations.

We urge the committee to avoid these problems by using a direct transfer mechanism between the Treasury and the Civil Service Retirement Fund.

The other non-design issue which is of concern to us is the proposal to contract for disability insurance with private insurance companies who would administer the program and pay out the benefits. The government already has (within OPM) the ability to administer the program. It makes no sense to try and duplicate (and pay additionally for) such functions by private sector contracts.

It would create a situation where employees would inevitably be treated differently by different insurance companies. Accordingly, we recommend that the Disability Trust Fund and program continue to be managed by OPM.

There are numerous other issues about which we also are concerned, and we have itemized here for reference and are prepared to explain them in greater detail as needed:

1) The disability provisions, in general, are well conceived and ably designed. However, the period of the long-term disability (LTD) should be increased from 1 year to 2 years in order to provide a more realistic opportunity for rehabilitation. This would not preclude medical reevaluations during such period of course, on account of which the benefit period may be terminated.

Additionally, we would propose that disability benefits continue until the annuitant is eligible for an unreduced retirement benefit under Social Security or the Civil Service, as appropriate. We note that Social Security disability benefits continue until the wage-earner is eligible for a full retirement and we think this practice should be paralleled.

2) Because of potential ambiguity in the proposed definition of military service technician, we suggest that National Guard technicians be specifically referenced. Also, because these civilian technicians have a mandatory retirement age of 60, they should be provided with a supplement equal to their Social Security benefit at age 62 until they are eligible for Social Security. This would be similar to the provision for fire fighters, law enforcement, and air traffic controllers. Finally, those technicians who lose their civilian job as a result of losing their military status for non-disability reasons should be eligible for an unreduced annuity at the time of separation.

3) There is currently a provision to allow individuals on leave-without-pay for union activities to continue in the retirement plan. Such individuals pay the equivalent of agency and employee contributions (14% of pay). S. 1527 should be amended to include a similar provision.

4) The interest on the investments of the CAP in government securities is tied to 2-year securities. This, unrealistically, lowers the employees' interest from this source and would encourage them to withdraw their funds from government securities. We urge the interest be determined from longer-term securities, as is the current practice, or from a favorable index of the range of government securities.

5) Section 8461 permitting unrestricted contracting-out of the administration of the retirement program should be deleted.

6) We think the one-year period for the transfer option is too restrictive. It simply is not enough time for employees to weigh their options and trade-offs. Regulations implementing this provision may not be complete until well into that one-year period. We urge the one-year period be extended to two years.

7) District of Columbia employees will not be covered by this plan and new D.C. employees will be severed from the Civil Service Retirement System effective January 1, 1987. In order to provide for an orderly transition and to allow D.C. employees (and their representatives) and the D.C. Government time to adequately prepare and negotiate over this major change, we urge that this date be moved to January 1, 1989.

8) A major step forward in the debate over Civil Service retirement has been accomplished in the effort to design

this system; namely, everyone is singing from the same song book--the model developed by the Congressional Research Service with assistance from the General Accounting Office, Congressional Budget Office, and outside experts. For this reason, we urge consideration of using this model in calculating the dynamic normal cost of the system. Furthermore, we strongly urge that the legislation require this cost be the operative cost for all government decisions which include retirement as a factor (such as A-76 contracting-out studies).

9) One way to increase portability would be to allow service transfer between retirement systems in the Federal government such as between railroad retirement and Civil Service retirement.

10) Care must be taken in this new plan not to unthinkingly disrupt the unique requirements and personnel system in the Foreign Service. We would hope that this committee would carefully deliberate before any such precedents were introduced.

11) The definition of basic pay should be clarified to insure that it means pay established pursuant to law and subject to any applicable pay ceilings.

Finally, we would like to touch on one of the most complex areas in this whole issue -- the management and investment of the funds in the CAP. Because of this complexity, we are still investigating the range of options and still evaluating the proposal in the bill.

Our investigations will be based on several principles.

First, these monies are the employees' money and must be invested in their best interest. Second, because of the size of this fund, the public interest must be represented and guarded. Third, once again, because of the fund's size, the danger of disrupting markets, inadvertently or for political purposes, must be guarded against. Fourth, the use of this fund must be socially responsible and such responsibility should be a feature of its investment strategy. Finally, ERISA standards should serve as guidelines to the administration of the fund in order to protect the integrity of the investments.

We will continue our research and discussions along these lines, and look forward to working with the Committee soon on these challenging and procactive issues. We wish to add in closing that we agree with the Committee that a good part of these funds should be invested in the private sector. Employees deserve the greatest available return for their dollar. We do not believe the currently proposed investment strategies would do that, and that is one of the reasons we are looking deeper into the issues.

Thank you.

Senator STEVENS. The committee will be in recess until 10 a.m. tomorrow.

[Whereupon, at 5:10 p.m., the hearing was recessed to reconvene at 10 a.m. the following day.]

CIVIL SERVICE PENSION REFORM ACT OF 1985

TUESDAY, SEPTEMBER 10, 1985

U.S. Senate,
Committee on Governmental Affairs,
Washington, DC.

The committee met at 10:05 a.m. in room SD-342, Dirksen Senate Office Building, Hon. Ted Stevens presiding.

Present: Senators Stevens, Eagleton, Glenn, and Gore.

Senator Stevens. Good morning.

We will first hear from Vincent Sombrotto, president of the National Association of Letter Carriers, and Tom Griffith, president of the National Rural Letter Carriers' Association. Let me just say, it is our intention to run through the day with the hearing. Senator Eagleton will come in just before noon, and he will hear witnesses during the period between 12 and 2, and then I will come back at 2 and continue through until 5. So we are going to try our best to hear all the people who are on the witness list today.

There will be Senators coming and going all day long because of other meetings. I say that so people will know in advance that there probably will be a necessity for some people to be here through the noon hour. It is Senator Eagleton's desire to be here durinq that period.

Good morning. It is nice to have both of you here. Go ahead.

TESTIMONY OF VINCENT R. SOMBROTTO, PRESIDENT, NATIONAL ASSOCIATION OF LETTER CARRIERS (AFL-CIO); AND TOM W. GRIFFITH, PRESIDENT, NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

Mr. Sombrotto. Mr. Chairman, my name is Vincent R. Sombrotto. I am president of the National Association of Letter Carriers, a labor organization representing over 271,000 members who are either presently employed as city delivery carriers by the U.S. Postal Service or who are retired from such employment.

This morning I would like to summarize my testimony and submit the full testimony for the record.

Senator Stevens. I might say for all the witnesses, all statements will be printed in full in the record. We do appreciate your summarizing it. Thank you.

Mr. Sombrotto. I would like to submit an additional statement from FAIR, the Fund for Assuring an Independent Retirement.[1]

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[1] See p. 942.

The NALC welcomes this opportunity to testify on S. 1527. We appreciate your support of the present civil service retirement system. As you know, an adequate retirement system is a small price to pay for qualified personnel.

The bill reflects the hard work and thoughtful approach of you and your staff. You have shown good faith and we support your efforts to reach an accord by involving all parties.

We also support the three-tiered approach to a new retirement plan.

I would like to start by focusing on some of the defined benefits of this bill.

NALC members are committed to maintaining age 55 with 30 years service as a feature of retirement. Letter carriers perform physically gruelling work—back and foot problems plague both active and retired carriers. Age 55 has become more than an important symbol for us. It represents the substance of our job: hard work.

The savings for the Government in this area are minor, particularly compared to the importance it holds for our members.

According to the April 1985 Hay-Huggins Co. report, overall compensation for Federal employees is 7.3 percent behind the private sector. The report concluded that retirement age and a full COLA are vital in order to be competitive with the private sector.

The 55 retirement age with 30 years service provides two additional advantages. First, it encourages workers who have expertise to stay until full retirement, which benefits the Postal Service. Second, it is an incentive that enables retirement at 55 and 30, making room for new, younger employees. E.I. DuPont and other companies recently opened their policy for early retirement and found that it had the added benefit of boosting employee morale.

The 2-percent per year penalty for early retirement would have several negative effects: It deters qualified applicants from seeking Postal Service employment and imperils the standard of living of retirees. A similar circumstance results from section 8414, which provides for a 5-percent penalty.

Section 8413 of this title affects retirement by establishing a formula for computing the annuity as 1 percent of the average of the highest 5 consecutive years multiplied by the number of years of service. The combination of these two factors would reduce annuities considerably. Moreover, it has a multiplying effect over the years compounded by its negative effect on the COLA.

The average high-3 years for a 55-year old letter carrier today with 30 years of service is $22,801. Minus survivor annuity and health insurance, it is a modest $10,949/year. That amount is further reduced by taxes.

That same person retiring at the same age under S. 1527 would receive a basic annuity of $8,740/year only if he could afford to contribute a full 10 percent of salary to the thrift plan. The annuity is $5,290/year which is close to the Government poverty level if the letter carrier is unable to contribute to the thrift plan. At $8,740/year, the carrier is receiving 32 percent less than a CSRS retiree despite contributing 126 percent more toward retirement. Neither the $8,740 nor the $5,290 includes deductions for health insurance or survivor annuity, approximately $1,900/year.

Senator Stevens. Mr. Sombrotto, I don't understand those figures. Contributing 126 percent more to retirement? Currently they are contributing 8.3 percent, and under this bill, 7 percent. How could they be contributing more?

Mr. Sombrotto. When you add the Social Security element to it and the thrift plan, particularly if they go to the max under the thrift plan as outlined in the present bill, they would contribute 10 percent of their salary. If they only contributed 5 percent of their salary, it still would be significantly more, when you factor in the Social Security.

Senator Stevens. They don't contribute to the pension at all. They contribute 7 percent which is less than others contribute to Social Security now. I don't see how it would be more even if they contribute the full 10 percent to the thrift plan. Our computations don't bear that out. We are going to have to get together on the numbers. These numbers and ours don't jive.

Mr. Sombrotto. We will be very happy to furnish our source for the numbers we have provided.

Senator Stevens. We will be glad to have it. You are not figuring in Social Security. You are saying 55 and 30 and you are assuming the person is retiring early and you are taking the return for the 5 years before they get Social Security.

Mr. Sombrotto. That will be 7 years before they would be eligible for Social Security.

Senator Stevens. That's right.

Mr. Sombrotto. And they would have a drastically reduced annuity during that period of time.

Senator Stevens. You are talking about 20 percent of the people who currently retire early under the age 55 concept.

Mr. Sombrotto. Yes.

At age 62, 30 years of experience, 19 percent of the retirees annuity comes from the thrift plan. I must make an additional point here. There is nothing to prevent Congress from reducing the thrift plan like it has done with the COLA's. Judging from the last few years, such a change will be tempting for deficit reduction.

Mr. Chairman, those annuities are subject to taxes. They amount to a retirement that is too low for such dedicated, productive service.

Most carriers have salaries in the $20-30,000 range. Yet this plan is tilted to either those who make much more—since they can utilize the entire thrift plan—or those under $20,000, due to the Social Security replacement rate.

With this modest annuity, a full COLA becomes critical to our retirees. Subchapter VI, section 8462 establishes a CPI minus 2 percent formula, which is used for those on retirement, disability and survivor annuities.

According to the administration's inflation projection for the next 3 years, there will be 12.6-percent inflation. Using CPI minus 2 percent, retirees' purchasing power for food, clothing, et cetera would be cut by almost 50 percent. For some retirees, this results in a tragic 'heat or eat' situation.

We support full inflation protection in the new supplemental to prevent what has happened over the last 5 years when our COLA's were cut severely. Retirees received just one COLA in the past 25 months. Between February 1981 and May 1984, our COLA was reduced by more than 9 percent. Since the vast majority of our retirees live on fixed incomes, COLA changes are a sword over their heads.

Section 8418 discusses agency contributions but it is ambiguous. We would like a clarification on the role of OPM as well as USPS contributions.

Since I have been emphasizing parity with the current civil service retirement system, the same is true in the employee contribution area.

Pre-1984 employees contribute 7 percent to their retirement program, CSRS. According to the statistics by the Congressional Research Service, if new hires contributed 7 percent of pay minus the amount paid for OASDI, the entire retirement system becomes 1.1 percent less expensive for the Federal Government. This additional revenue from employees would enable increased defined benefits with no additional cost to the Government.

In addressing subchapter III of title I, the thrift plan, I would like to reiterate that I support the concept. However, Treasury Department's statistics for the spring of 1985 show that IRA's mainly are utilized by households with real income levels of more than $40,000. The average letter carrier earns $23,000/year.

Therefore, a supplemental which uses thrift savings to make it attractive is fine. But one which counterposes a thrift to important defined benefits will mainly benefit the minority of higher paid employees at the expense of the majority. We support cutting back on that portion of the cost to the Government, which would be consistent with the private sector and President Reagan's Treasury II proposal. We would like more money in defined benefits.

The well-being of a spouse is important to letter carriers. In order to receive survivor benefits, retirees pay approximately 10 percent of their annuity yearly.

S. 1527 changes the benefits for a preretirement surviving spouse. Furthermore, benefits cannot be collected before the date at which the letter carrier could have retired.

In the case of a 42-year old widow whose husband died at age 45, she would not be able to collect supplemental benefits until she reached age 52. This is a drastic change from the current civil service retirement system which has no age requirement. She would collect Social Security if her husband qualified, but her combined annuity would be below the poverty line.

Senator STEVENS. You are right and we are going to take care of that. We understand that. As I said, we made some modifications but we intend to do what you just said. We agree with you.

Mr. SOMBROTTO. We are happy to hear that.

In monetary terms, S. 1527—then I won't read that if you are going to take care of it. [Laughter.]

I would like to discuss the topic of disability retirement. Section 8446 allows the USPS to offer other craft employment in lieu of retirement. We wrestled with this problem in 1969 and 1970 during discussion of the Postal Reorganization Act. Congress decided that it would be a bad policy. It came up again in 1981 as part of the "Gramm-Latta" budget. Once again, House-Senate conferees agreed that it was disruptive to the Postal Service because it blurs job distinctions in the Postal Service and would create havoc.

I can foresee from the experience of other unions a situation of endless, costly grievances and lawsuits and disgruntled employees who see better paying jobs or chances for advancement taken away.

Section 8450 establishes an Employees' Disability Insurance Fund in the U.S. Treasury and requires agencies to make payments to the fund from salary appropriations. However, a third party would administer payments. This would add expensive, private-sector participation rather than continuing the current OPM operation. The potential for confusion and entangled paperwork is enhanced.

In the Stevens-Roth bill, letter carriers covered under the present civil service retirement system can transfer to the new system. We agree that both systems need to be financially sound and under one roof. However, when a system as complex as this supplemental is started, it seems prudent to wait for a couple of years to see what problems appear. No matter how much we try to head-off trouble, we know that we cannot predict all possible problems.

In addition, there would be legislative considerations involved in opening up the Social Security Act. Transfers raise the possibility of the Senate Finance Committee sharing jurisdiction with Governmental Affairs on S. 1527. I don't know, maybe that is what you want to do.

One omission from the bill: How to handle the problem of rehires. How does the supplemental plan handle someone who has previous service in the Government and has contributed to the civil service retirement plan but has been rehired as a new employee and will be covered by the new supplemental plan? The bill does not address this issue and it will be an important issue for a large number of Government employees, some of whom are already in the employ of the Government. In certain cases, some of these individuals are vested in the CSRS.

As you can see, Mr. Chairman, there are areas where we believe benefits must be restored to current levels and improved. And there are areas where we think letter carriers can give more. If you have any questions, I will be glad to answer them.

Senator STEVENS. On your last point, I thought we handled that. We treated a rehire as a transfer and the rehire can keep his or her credit under the old system and then build up credit under the new system. So upon retirement you really have computations under two systems. I don't see any problem with that.

Mr. SOMBROTTO. We don't have any problem with that aspect of it. You will have to excuse us for not being more precise in our testimony. We are talking about folks that take their money out and leave the employ, take their contributions out and then get rehired. It creates a different problem.

Senator STEVENS. They would have to redeposit under the old fund. Under the new fund they wouldn't have to redeposit.

The pension plan would be the same and the Social Security plan would be the same, if they are a new hire and were never covered under civil service. If you are under civil service and took your money out, as some of us have in the past, you have to put it back in when you are rehired. It is just like a transfer.

Senator Gore, do you have any questions?

Senator GORE. Why don't we hear from Mr. Griffith?

Mr. GRIFFITH. Thank you, Mr. Chairman, I have submitted some prepared testimony for the record and I will offer a brief summary.

My name is Tom Griffith. I am president of the 66,000-member National Rural Letter Carriers' Association. We are honored to appear before the Committee on Governmental Affairs and to offer our testimony on your bill.

We compliment you on the series of pension forums. They were unique and educational. They provided a good opportunity to bring forth diverse information.

Let us for the record say that it is our desire to see a bill passed into law this year. But if it takes slightly longer, then let's not sacrifice quality for haste.

We see merit in the basic design and appreciate the effort that you and your staff have put into it, but we would like to see improvements or modifications made to some areas.

I will attempt to outline those areas of the plan which we are particularly pleased with, and those areas in which we believe some fine-tuning will improve the bill.

We view the program as consisting of three tiers, the first of which is Social Security. There is a tilt to the Social Security tier in favor of the lower-income employee.

The second tier is a defined benefit plan. We are pleased with your add-on approach. Higher salaried employees have more disposable income and, therefore, have the ability, through their own savings initiative, to compensate for the Social Security tilt.

The employee contribution level should roughly equal current contributions to the civil service retirement system. We recommend that employees contribute to the defined benefit program in an amount which will provide equal contributions between the existing retirement plan and the proposed plan.

A plan in which the employees have a direct stake in funding should discourage legislative tampering in the future.

We recommend that the accrual rate in the defined benefit plan be increased in later years of employment. There should be incentive and reward for longer service.

We approve of most of the vesting and age schedule, with the exception of the penalty for early retirement. We would like to see the bill changed so employees would have the ability to retire after 30 years of service at 55 years of age without any penalty. We propose that employees who would be interested in an early retirement option could contribute an additional amount to an optional program, which would also be matched by an equal amount from the employer.

We support a high-3-year average salary instead of a high-5-year salary base for annuity computation.

We appreciate the fact that in your bill all funds from the defined benefit program would flow into the existing civil service retirement fund, which will protect the assets of that fund in perpetuity for all those who will be retiring under the old system.

The cost-of-living adjustments should be fully indexed. When Government uses a fully indexed COLA, it often becomes a model for retirement plans in the private sector.

The third tier is the savings portion. We compliment you on your innovation and flexibility in the design of this section. Our particular membership would prefer slightly less emphasis on savings and a little more on the defined benefit.

Voluntary contributions by an employee should be allowed up to 10 percent of their salary. We recommend that the Government's dollar-for-dollar match should be limited to 3 percent of salary. The 5-percent Government matching contribution proposed in the bill is too costly. We would prefer shifting part of that benefit to the second tier of the plan.

Recently, the President amended his tax reform proposal to urge repeal of the 401(k) tax-shelter capability. His proposal gives us cause for concern about the saving section contained in this bill. A loss of any tax deferral provisions would be a significant loss to employees who will be covered by the new plan. We certainly urge retention of this tax benefit.

If a modest reduction is made in the capital accumulation section, together with an employee contribution, the COLA program would continue as it exists in the current system with virtually no added expense to the employer.

Mr. Chairman, again, we offer our appreciation to you and your staff for the care and concern you have shown in developing this very fine piece of legislation. With the fine-tuning we have suggested, we could support the bill. We look forward to continuing to work with you on this complicated issue and appreciate your interest and concern about an adequate retirement program for new rural carriers.

Thank you.

Senator STEVENS. Thank you very much.

We are going to do what we can to restore the 55–30. We are checking the figures that CRS gave us. Those haven't been confirmed yet. You realize, the problem with the 55–30 is that Social Security is payable at age 62, so the problems you mentioned stem from the retirement age of Social Security, not from the retirement age of our plan. It would be very costly to, in effect, take insurance to pay the equivalent of Social Security until eligible for Social Security for those people who retire after 30 years. The gap in there is one that was created by the congressional action to cover Federal employees by Social Security, not by our plan. CRS tells us we could have 55 and 30 retirement for a ½ percent of payroll. As I said, we are checking that. I would like to restore that but it won't restore the gap between 55 and 62 with regard to Social Security. That is the real problem as far as the person aged 55 who has 30 years. They could be 57, but at least 55 with 30 years.

That little gap in there is the one we are looking at. If we go to 55 and 30, it wouldn't quite be retirement unless we can actually make up for the lost Social Security too. We would like to work with you on it. I agree with you. I don't think we are wedded to the 5-percent matching, although I would rather yield that to my friend, Mr. Ford, in conference than to you here.

Mr. GRIFFITH. I understand. [Laughter.]

Senator STEVENS. We are going to have to deal with this adjustment as we go on. You both make very good points. I don't have any questions. I just hope you understand our basic problem as far as the age 55 retirement. It won't be full retirement for civil service because we can't amend Social Security and say for Federal employees you pay them at 55, notwithstanding the age 62 concept that applies to everybody else. I just don't think you can do it. I hope you can help us find some way to bridge that gap.

Gentlemen, do you have any questions?

Senator GORE. I think he wanted to comment.

Mr. SOMBROTTO. Sitting next to me is my legislative and political assistant, George Gould. I neglected to identify him earlier. I assure you, we are exploring every possibility of how to narrow that gap you rightfully pinpointed, that period between age 55 and 62 under the present bill. So we are working on something and I am sure as soon as we come up with a solution, we will be glad to give it to you.

Senator STEVENS. Thank you very much.

Senator GORE. Thank you. You really didn't need to introduce George. We all know him and Ken for that matter.

Mr. SOMBROTTO. That's what he just told me. [Laughter.]

Senator GORE. How long does it typically take letter carriers to top out or reach the upper levels of promotion and compensation?

Mr. SOMBROTTO. You say promotion; 96 percent of letter carriers don't get promoted. They come in at one level and they retire at one level. That is a level 5. Very, very few get promoted. The only upward mobility is into management. Very few go into management. It varies. Those that do go into management could do it after 2 years or 20 years. There is no specific timeframe.

Senator GORE. Do you have anything to add to that?

Mr. GRIFFITH. No, we are under the same program.

Senator GORE. What is your position on the later retirement age proposed in the legislation?

Mr. SOMBROTTO. I speak for myself here, but I listened to Tom's testimony and we are both opposed to any increase in the age for retirement particularly in our cases. Both of us do the same type of work and 30 years of carrying mail, whether they are rural carriers or city delivery carriers, is physically debilitating and we see no reason why anybody should have to work beyond 30 years or 55 years of age.

Senator GORE. You mentioned your support for the full indexing for inflation. Would you have any objection to trying the COLA provisions in the bill to the Social Security COLA?

Mr. SOMBROTTO. No.

Senator GORE. Mr. Griffith.

Mr. GRIFFITH. I would like to add the fully indexed COLA; if that's the way the Social Security COLA is going to be indexed now and in the future, that will be fine, provided it remains fully indexed.

Senator GORE. Of course, if you can imagine the time when the Social Security COLA was not allowed and yours was, that's hard to imagine. I understand your statement.

Mr. SOMBROTTO. We are depending on your wisdom to figure that out.

Senator Gore. Thanks.

Mr. Griffith, you indicated in your prepared statement that you would favor increasing the accrual rate from the 1-percent level currently employed in the Stevens-Roth plan. Given the cost considerations that we are confronted with, would you be willing to consider a back-loaded or step-rate accrual as a cost-neutral change which would favor those employees with more seniority?

Mr. Griffith. Such as we have in effect now, yes.

Senator Gore. All right, fine. And you would favor that, if you couldn't get the 1 percent?

Mr. Griffith. If we couldn't get that increase across the board.

Senator Gore. You also advocated level contributions as a means of providing a sense of equality among employees and providing a degree of political security. Although that amounts to a 1.1-percent decrease in the overall system cost, why wouldn't it be more beneficial to forgo the contribution requirement and allow the employees the option of putting that money into the thrift plan?

Mr. Griffith. We would prefer that benefit to be put in the defined benefit portion rather than the savings—that the defined benefit portion be stronger or more significant.

Senator Gore. Presumably that would have more of an impact on what you referred to as political security concerns also.

Mr. Griffith. Yes, sir.

Senator Gore. I may submit some additional questions to both of you in writing for the record, if you would be willing to respond.

I just wanted to say, in closing, that I share the concern that Senator Eagleton expressed yesterday that our deliberations on this bill not be construed or used in any way to recast the current civil service retirement system, and I am wondering if either of you have any suggestions on how to foreclose that from taking place?

Mr. Griffith. No, sir; quite frankly, at the present time.

Mr. Sombrotto. No, sir.

Senator Gore. Well, think about it. And if you have any ideas, please let us know. Those are all the questions that I have. I am sure Senator Eagleton has some.

Senator Eagleton. I would like to pursue a little further with both of the witnesses the next to the last question that Senator Gore pursued, this 1.3 percent. Some of you were perhaps in the audience yesterday when Mr. Blaylock and Mr. Biller were here. We pursued this, just to put it in context. A civil service worker under the old system puts 7 percent into the system and 1.3 percent into medicare for a total out-of-pocket expenditure to him of 8.3 percent. The Stevens bill before us has 7 percent. That is all that comes out of the employee's pocket, 7 percent into Social Security. That's it. So in terms of what comes out of the employee's pocket, just looking at that, at the Stevens bill as written, it is more beneficial to the employee than what some previous witnesses have proposed, in terms of out-of-pocket to the employee; it is 1.3 percent more beneficial.

Mr. Sombrotto, why is it that you support taking more money out of the pocket of the new employee than Senator Stevens proposes in his bill?

Mr. Sombrotto. Well, because the 7-percent contribution derives less benefit to the employee. If you take the 1.3 and turn it into defined benefits, we think it brings us closer to the parity that we are striving for between those employees who are covered under the present CSRS and those new employees who came onboard after January 1, 1984.

Senator EAGLETON. Putting it in other figures, the cost of the Stevens bill as a percent of payroll is 20.8 percent. If we used the 1.3 in computing benefits, of course the cost as a percent of payroll would still be the same, 20.8 percent, but we could use the 1.3 percent to juice up the benefits more. We could use it to juice up COLA, to juice up the retirement age, to juice up the accrual figure, to juice up the disability figure, or however. So is the thrust of your testimony with respect to this item that you would be able to persuade your new employees—just focusing on them—that it is better for them to pay more money now out of their pocket to get more benefits later when they retire? That's about the bottom line.

Mr. SOMBROTTO. That is absolutely correct. If I am allowed, they are not our employees, they are our members.

Senator EAGLETON. Call them members.

Mr. SOMBROTTO. We have a little problem with that as a union.

Senator EAGLETON. Your members—that is correct. I stand corrected.

Mr. SOMBROTTO. Yes; I go on record challenging anybody—if anybody wanted to do a poll, or a test, or have a vote on it—I guarantee you those new members would rather invest a little more so that they can have more when they are ready to retire. We have done our own informal poll.

Senator EAGLETON. Let me take you a step further. Suppose, starting with the Stevens bill, we, this committee, did somewhat better—and I won't define what somewhat better is because this is debatable—we did somewhat better on COLA, we did somewhat better on the 55 retirement age and we did somewhat better on the accrual figure, and then we decided to throw the 1.3 percent into the thrift plan with the consequence that everybody, every new employee, thus every new member of your union, would automatically have 1.3 put into the thrift plan and that would be matched by another 1.3 from the Government, and the new member would have this as long as he worked, portable to take with him or her when they left, wouldn't that be a pretty good deal?

Mr. SOMBROTTO. Well, if you are asking for a choice between the two situations, we would opt for the former, which would put it into defined benefits rather than the thrift plan.

Senator EAGLETON. The new employee can't take the defined benefit with him or her.

Mr. SOMBROTTO. That is why they invest in it because they look—it's an investment in your future, that is all it is. We see it as something that is much more desirable than the question of the thrift plan.

Senator EAGLETON. What is the dropout rate of letter carriers? What figures can you supply us, how many people leave after 1 year, 3 years, 5 years, 10 years?

Mr. SOMBROTTO. That's a hard figure—it's an elusive figure. Let me say this, Senator. It is based on what is happening in the economy or happening in our country at a particular period of time. Right now the quit rate or dropout rate is very low, but 5 years ago, 8 years ago it was very high. It might shift and change. There is an ebb and flow to that figure. If you are asking me at the present time, it is low.

Senator EAGLETON. Why shouldn't a person, say, put in 5 years, pick 5, pick 10, 3, whatever—serves as a letter carrier, decides he can get a better opportunity with company X, and takes that opportunity; why shouldn't he have something portable to take with him which the thrift plan provides?

Mr. SOMBROTTO. Under the present system, he would have Social Security to take with him.

Senator EAGLETON. Yes; but why shouldn't he have something else? You can't take that defined benefit with you. He can take the thrift plan with him. Why isn't that a better deal?

Mr. SOMBROTTO. It may be; I am not prepared to argue for or against that proposition. Our union's thrust is not for the person who leaves after 5 years, 7 years, or 10 years; it is to protect the interest of the person who goes the whole route. That is the overwhelming majority of people who come to work in the Postal Service. They stay until they retire, particularly letter carriers and Tom can speak for rurals in that regard. That is who we want to protect, the people who will stay the whole route.

Senator EAGLETON. That has not always been in a generic sense the position of the AFL-CIO. I was on another committee just yesterday and we had a series of hearings on pensions and pension reform and pension protection, and portability was a key issue and something the AFL-CIO very much wanted. Indeed there are some unions where there is great movement in that. They like as a generic proposition portable pension plans.

Mr. SOMBROTTO. I am a vice president as you may or may not know on the AFL-CIO executive council. I assure you there are positions we take or don't take in our executive sessions which I agree with or disagree with. This is one. I agree people in the private sector should have that portability. They have a different setup. But I would point out that in terms of letter carriers, a letter carrier that came to work 20 years ago, or 10 years ago, or is coming to work today, has a 90-percent chance of staying in the same job at the same level for 30 years and be eligible for retirement.

There are very, very few industries or very, very few jobs where people have that kind of commitment to long-term employment. That's the difference.

Senator EAGLETON. I think you are right. I suspect yours tends to be the most continuous employee before us.

Mr. Griffith, just to shorten this up, do you agree in whole with the comments made by Mr. Sombrotto, and if you do not agree, please point out the areas wherein you disagree?

Mr. GRIFFITH. Substantially I agree, Senator. I think we see benefit or reason for employees to make this kind of an investment in the future. We feel if the employee has an investment or contribution, it may tend to do away with some tampering in the future by future Congresses. We would like to help pay for this system and perhaps trade it in for a full COLA.

Senator EAGLETON. I read this into the record. This comes from GAO: "If you put the 1.3 that we've been discussing into the thrift plan, that will increase the benefits for the employee when he or she retires by 12 percent; if you put that same 1.3 into the defined benefit it will translate into 3 percent enhancement of the employee's benefits."

This is what the General Accounting Office tells us. If you think they are all wet, I wish you would get us some material that tells us that because if they are right, you simply cannot sustain your position.

I would be willing and Senator Stevens would be willing to debate the issue in front of your new members. If you are going to get up and tell your new members: "New members, we are demanding that the Congress take more money out of your pocket, they aren't taking enough out of your pocket. I as your leader am insisting they take more out of your pocket and when they take more out of your pocket you are going to get less benefits when you retire." And Stevens gets up or Eagleton says: "Members, I am just a little outsider who has been invited here. What I am humbly suggesting is we take less out of your pocket an alternative, we will match the same as you take out of your pocket and we'll give you a lot more benefits in the end." Now, if the house ain't rigged, I got a chance on that debate. [Laughter.]

Mr. SOMBROTTO. Let me make a few comments. Who are you invited by?

Senator EAGLETON. I am hoping you might invite me. [Laughter.] I only want to talk to your new members.

Mr. SOMBROTTO. I understand.

Senator EAGLETON. I have a suspicion that the old members, and there are more of them right now, want to force the new members to pay more to protect the old members. We are writing a plan for the new members—for the new members. I think when you tell those new members for that 1.3 we can get them 12-percent enhancement in benefits if they want to pay, vis-a-vis a 3-percent enhancement, if the GAO is right on those figures, they have to opt for the 12.

Mr. SOMBROTTO. If that were the choice, it would be an options choice, wouldn't it? If somebody could support those figures.

Let me point out the 12 percent you are talking about is built on the presumption of certain factors in the economy which no one could absolutely guarantee. And so I would suspect if you went before those very members and we debated the issue, they would say—and not meaning to be disrespectful because I certainly could not ever be disrespectful to Senator Eagleton—but they would say it's the same old story, politicians say pay less, get more, until the time the payroll comes.

I don't question what you are trying to say if there was a guarantee. If you told me and if you told Tom and you told all of us who represent our members—I might also point out all of us get elected by those members, so we don't want to make the wrong decisions—if you guaranteed absolutely to a moral certainty that if you invested 1.3 you were going to get 12 percent in benefits as opposed to getting less, I suspect we would have to take a harder look at it. But I don't think you can guarantee that and I don't think the people that develop these numbers can guarantee that. It is based on assumptions on an economy that generates *x* amount of interest on investment and I don't know that that can be relied on.

Senator EAGLETON. I have one more question that Senator Stevens wanted to ask, Mr. Sombrotto. What would be your position on cutting the Postal Service out of this bill and making retirement subject to bargaining?

Mr. SOMBROTTO. Cutting it out of the bill and use bargaining with the Postal Service for retirement? I would favor that.

Senator EAGLETON. You would favor that?

Mr. SOMBROTTO. Yes.

Senator EAGLETON. I don't have anything else.

Mr. GRIFFITH. Senator.

Senator EAGLETON. Mr. Griffith.

Mr. GRIFFITH. I would like to reserve my judgment on that. I have not taken a position on it.

Senator EAGLETON. OK. Thank you both very much.

Senator GORE [presiding]. Thank you both very much.

I believe Senator Stevens may have some additional questions in writing for the record also. We certainly appreciate your presence here.

Mr. SOMBROTTO. Let me say for myself and certainly for the members that I represent, we respect the work that you are doing. We recognize how difficult the task is and we know you are trying to come up with a supplemental retirement for those new employees that is going to be fair, and equitable, and meets the test that is necessary. So we appreciate all of what you have done and I say that sincerely.

Senator GORE. Thank you, we will continue working closely with you.

[The prepared statements of Messers. Sombrotto and Griffith follow:]

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TESTIMONY

OF

PRESIDENT VINCENT R. SOMBROTTO

OF THE

NATIONAL ASSOCIATION OF LETTER CARRIERS

BEFORE THE

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

ON

SUPPLEMENTAL RETIREMENT PLAN

September 10, 1985

CONGRESSIONAL TESTIMONY

MR. CHAIRMAN. MY NAME IS VINCENT R. SOMBROTTO. I AM THE PRESIDENT OF THE NATIONAL ASSOCIATION OF LETTER CARRIERS (NALC), A LABOR ORGANIZATION REPRESENTING OVER 271,000 MEMBERS WHO ARE EITHER PRESENTLY EMPLOYED AS CITY DELIVERY CARRIERS BY THE U.S. POSTAL SERVICE OR WHO ARE RETIRED FROM SUCH EMPLOYMENT.

THIS MORNING I WOULD LIKE TO SUMMARIZE MY TESTIMONY AND SUBMIT THE FULL TESTIMONY FOR THE RECORD. ALSO, I WOULD LIKE TO SUBMIT AN ADDITIONAL STATEMENT FROM FAIR, THE FUND FOR ASSURING AN INDEPENDENT RETIREMENT.

THE NALC WELCOMES THIS OPPORTUNITY TO TESTIFY ON S. 1527. WE APPRECIATE YOUR SUPPORT OF THE PRESENT CIVIL SERVICE RETIREMENT SYSTEM, WHICH IS A MODEST EXPRESSION OF APPRECIATION FROM THE GOVERNMENT TO ITS EMPLOYEES. AS YOU KNOW, AN ADEQUATE RETIREMENT SYSTEM IS A SMALL PRICE TO PAY FOR QUALIFIED PERSONNEL.

THE BILL REFLECTS THE HARD WORK AND THOUGHTFUL APPROACH OF YOU AND YOUR STAFF. YOU HAVE SHOWN GOOD FAITH AND WE SUPPORT YOUR EFFORTS TO REACH AN ACCORD BY INVOLVING ALL PARTIES. SUCH A PROCESS IS CRUCIAL TO SUCCESS. THIS BILL IS A FRAMEWORK FROM WHICH TO WORK. SINCE POST-1983 HIRES FACE THE PROSPECT OF PAYING OVER 14% TO RETIREMENT STARTING NEXT YEAR, I HOPE WE CAN EXPEDITE THIS PROJECT.

WE SUPPORT THE THREE-TIERED APPROACH TO A NEW RETIREMENT PLAN CONSISTING OF SUPPLEMENTAL DEFINED BENEFITS, A VOLUNTARY THRIFT PLAN AND SOCIAL SECURITY. THERE ARE SOME AREAS WHERE OUR UNION WOULD MAKE SOME CHANGES.

I WOULD LIKE TO START BY FOCUSING ON SOME OF THE DEFINED BENEFITS OF THIS BILL, WHICH IS TITLE I, SUBCHAPTER II, AFTER WHICH I WILL PROJECT ANNUITIES FOR OUR MEMBERS.

NALC MEMBERS ARE COMMITTED TO MAINTAINING AGE 55 WITH 30 YEARS SERVICE AS A FEATURE OF RETIREMENT. LETTER CARRIERS PERFORM PHYSICALLY GRUELLING WORK -- BACK AND FOOT PROBLEMS PLAGUE BOTH ACTIVE AND RETIRED CARRIERS. AGE 55 HAS BECOME MORE THAN AN IMPORTANT SYMBOL FOR US. IT REPRESENTS THE SUBSTANCE OF OUR JOB: HARD WORK.

WHILE MANY LETTER CARRIERS DO NOT HAVE 30 YEARS SERVICE AT AGE 55 AND STAY ON THE JOB, OTHERS TAKE ADVANTAGE OF THE RETIREMENT AVAILABLE. CONSEQUENTLY, THE SAVINGS FOR THE GOVERNMENT IN THIS AREA UNDER S. 1527 ARE MINOR, PARTICULARLY COMPARED TO THE IMPORTANCE IT HOLDS FOR OUR MEMBERS. ACCORDING TO CONGRESSIONAL RESEARCH SERVICE FIGURES, MAINTAINING AGE 55 RETIREMENT WITH 30 YEARS SERVICE REPRESENTS ONLY A 0.5% ADDITION TO THE PAYROLL COST TO THE GOVERNMENT. BUT TO OUR MEMBERS IT REPRESENTS AN IMPORTANT COMMITMENT TO THEIR WELL-BEING.

ACCORDING TO THE APRIL, 1985 HAY/HUGGINS COMPANY REPORT, OVERALL COMPENSATION FOR FEDERAL EMPLOYEES IS 7.3% BEHIND THE PRIVATE SECTOR. THE REPORT CONCLUDED THAT RETIREMENT AGE AND A FULL COLA ARE VITAL IN ORDER TO BE COMPETITIVE WITH THE PRIVATE SECTOR.

THE 55 RETIREMENT AGE WITH 30 YEARS SERVICE PROVIDES TWO ADDITIONAL ADVANTAGES. FIRST, IT ENCOURAGES WORKERS WHO

HAVE EXPERTISE TO STAY UNTIL FULL RETIREMENT, WHICH BENEFITS THE POSTAL SERVICE. SECOND, IT IS AN INCENTIVE THAT ENABLES RETIREMENT AT 55 & 30, MAKING ROOM FOR NEW, YOUNGER EMPLOYEES. AS A RESULT, LETTER CARRIERS REPRESENT A GOOD MIX OF EXPERIENCE AND YOUTH. MANY ADMINISTRATORS RECOGNIZE THAT AN AGE 55 RETIREMENT POLICY CUTS BOTH WAYS AND SUPPORT IT. FOR EXAMPLE, E.I. DUPONT AND OTHER COMPANIES RECENTLY OPENED THEIR POLICY FOR EARLY RETIREMENT AND FOUND THAT IT HAD THE ADDED BENEFIT OF BOOSTING EMPLOYEE MORALE.

THE 2% PER YEAR PENALTY FOR EARLY RETIREMENT WOULD HAVE SEVERAL NEGATIVE EFFECTS: IT DETERS QUALIFIED APPLICANTS FROM SEEKING POSTAL SERVICE EMPLOYMENT AND IMPERILS THE STANDARD OF LIVING OF RETIREES. A SIMILAR CIRCUMSTANCE RESULTS FROM SECTION 8414, WHICH PROVIDES FOR A 5% PENALTY FOR EACH YEAR THE PARTICIPANT IS UNDER AGE 62 FOR THOSE WHO HAVE LESS THAN 30 YEARS SERVICE BUT MORE THAN 10.

SECTION 8413 OF THIS TITLE AFFECTS RETIREMENT BY ESTABLISHING A FORMULA FOR COMPUTING THE ANNUITY AS 1% OF THE AVERAGE OF THE HIGHEST FIVE CONSECUTIVE YEARS MULTIPLIED BY THE NUMBER OF YEARS OF SERVICE. THE COMBINATION OF THESE TWO FACTORS WOULD REDUCE ANNUITIES CONSIDERABLY. FOR THE AVERAGE LETTER CARRIER, A HIGH-FIVE DETERMINATION ALONE REDUCES THE SALARY LEVEL APPROXIMATELY 9%. MOREOVER, IT HAS A MULTIPLYING EFFECT OVER THE YEARS COMPOUNDED BY ITS NEGATIVE EFFECT ON THE COLA.

I WOULD LIKE TO DEMONSTRATE THE EFFECTS OF THESE CHANGES ON OUR MEMBERS.

THE AVERAGE HIGH-THREE YEARS FOR A 55-YEAR OLD LETTER CARRIER TODAY WITH 30 YEARS SERVICE IS $22,801. UNDER THE CURRENT SYSTEM THAT PERSON'S BASIC ANNUITY IS $12,928; MINUS SURVIVOR ANNUITY AND HEALTH INSURANCE IT IS A MODEST $912.43/MONTH OR $10,949/YEAR. THAT AMOUNT IS FURTHER REDUCED BY TAXES.

THAT SAME PERSON RETIRING AT THE SAME AGE UNDER S. 1527 WOULD RECEIVE A BASIC ANNUITY OF $8,740/YEAR (OR $728/MO.) ONLY IF HE COULD AFFORD TO CONTRIBUTE A FULL 10% OF SALARY TO THE THRIFT PLAN. THE ANNUITY IS $5,290/YEAR ($440/MO.), WHICH IS CLOSE TO THE GOVERNMENT POVERTY LEVEL IF THE LETTER CARRIER IS UNABLE TO CONTRIBUTE TO THE THRIFT PLAN. AT $8,740/YEAR, THE CARRIER IS RECEIVING 32% LESS THAN A CSRS RETIREE DESPITE CONTRIBUTING 126% MORE TOWARD RETIREMENT. NEITHER THE $8,740 NOR THE $5,290 INCLUDES DEDUCTIONS FOR HEALTH INSURANCE OR SURVIVOR ANNUITY, APPROXIMATELY $1,900/YEAR. THAT RETIREE'S PROBLEMS ARE FURTHER COMPOUNDED BY NOT RECEIVING ANY SOCIAL SECURITY BEFORE AGE 62.

MR. CHAIRMAN, THOSE ANNUITIES ARE SUBJECT TO TAXES. THEY AMOUNT TO A RETIREMENT THAT IS TOO LOW FOR SUCH DEDICATED, PRODUCTIVE SERVICE. AND IF THE CARRIER PAYS A 5% PENALTY FOR LESS THAN 30 YEARS SERVICE, IT IS MUCH WORSE. WITH NO SOCIAL SECURITY BENEFITS BEFORE AGE 62, WE'RE FACED

WITH A SYSTEM THAT PLACES MANY RETIREES NEAR THE POVERTY LINE AND WILL RESULT IN INCREASED EXPENSES BY THE GOVERNMENT IN THE FUTURE TO COVER FOR BASIC NECESSITIES.

OTHER EXAMPLES ARE AT AGE 62 WITH 37 YEARS SERVICE. UNDER CSRS A RETIREE WOULD RECEIVE $15,180. IF A LETTER CARRIER WERE A NEW HIRE COVERED BY THIS SUPPLEMENTAL, THE BASIC ANNUITY LEVEL WOULD BE $19,550 IF A FULL 10% THRIFT CONTRIBUTION WAS MADE FOR ALL 37 YEARS. IF NO CONTRIBUTION TO THE THRIFT IS MADE THE ANNUITY IS $11,960. WHILE THE RETIREMENT OF $19,550 LOOKS BETTER, REMEMBER THAT IT IS THE RESULT OF 37 YEARS OF CONTRIBUTIONS AT 15.8% TO RETIREMENT AS OPPOSED TO 7% UNDER CSRS. AGAIN, HEALTH INSURANCE, SURVIVOR ANNUITY AND TAXES ARE NOT INCLUDED.

AT AGE 62 WITH 30 YEARS EXPERIENCE, 19% OF THE RETIREE'S ANNUITY COMES FROM THE THRIFT PLAN, WHICH IS WHY THERE IS SUCH A DRASTIC DIFFERENCE FROM THE PERSON NOT CONTRIBUTING TO A THRIFT.

I MUST MAKE AN ADDITIONAL POINT HERE: THERE IS NOTHING TO PREVENT CONGRESS FROM REDUCING THE THRIFT PLAN LIKE IT HAS DONE WITH COLAS. JUDGING FROM THE LAST FEW YEARS, SUCH A REDUCTION WILL BE TEMPTING FOR "DEFICIT REDUCTION." THE 19% OF THE 62/30 RETIREE CAN CHANGE QUICKLY.

MOST CARRIERS HAVE SALARIES IN THE $20-30,000 RANGE. YET THIS PLAN IS TILTED TO EITHER THOSE WHO MAKE MUCH MORE (SINCE THEY CAN UTILIZE THE ENTIRE THRIFT PLAN) OR THOSE UNDER $20,000 (DUE TO THE SOCIAL SECURITY REPLACEMENT RATE).

THE SITUATION FOR SOMEONE WITH LESS THAN 30 YEARS EXPERIENCE (BUT MORE THAN 10 YEARS) IS MUCH WORSE BECAUSE OF

THE 5% PENALTY FOR RETIREMENT BEFORE AGE 62. AS THE HAY STUDY POINTEDLY STATED: THE 5% PENALTY WOULD PUT OUR RETIREMENT BEHIND THE PRIVATE SECTOR.

WITH THIS MODEST ANNUITY, A FULL COLA BECOMES CRITICAL TO OUR RETIREES. SUBCHAPTER VI, SECTION 8462 ESTABLISHES A CPI MINUS 2% FORMULA, WHICH IS USED FOR THOSE ON RETIREMENT, DISABILITY AND SURVIVOR ANNUITIES.

ACCORDING TO THE ADMINISTRATION'S INFLATION PROJECTION FOR THE NEXT THREE YEARS, THERE WILL BE 12.6% INFLATION. USING CPI MINUS 2%, RETIREES' PURCHASING POWER FOR FOOD, CLOTHING, ET CETERA WOULD BE CUT BY ALMOST 50%. FOR SOME RETIREES, THIS RESULTS IN A TRAGIC "HEAT OR EAT" SITUATION.

WE SUPPORT FULL INFLATION PROTECTION IN THE NEW SUPPLEMENTAL TO PREVENT WHAT HAS HAPPENED OVER THE LAST FIVE YEARS WHEN OUR COLAS WERE CUT SEVERELY. RETIREES RECEIVED JUST ONE COLA IN THE PAST 25 MONTHS. BETWEEN FEBRUARY, 1981 AND MAY, 1984 OUR COLA WAS REDUCED BY MORE THAN 9%. SINCE THE VAST MAJORITY OF OUR RETIREES LIVE ON FIXED INCOMES, COLA CHANGES ARE A SWORD OVER THEIR HEADS.

AS I POINTED OUT, THE HAY REPORT UNEQUIVOCALLY STATED THAT TOTAL FEDERAL EMPLOYEE COMPENSATION IS BELOW THAT OF PRIVATE SECTOR EMPLOYERS IN VIRTUALLY EVERY ASPECT EXCEPT RETIREMENT AGE AND THE COLA, WHICH ARE THE PRIMARY REASONS THAT OUR COMPENSATION DOESN'T FALL DRASTICALLY BEHIND PRIVATE SECTOR PLANS.

FOR SOMEONE WHO IS LIVING ON A FIXED INCOME AND FACES

THE PHYSICAL PROBLEMS OF THE ELDERLY, CPI MINUS 2 IS A MAJOR HARDSHIP. WE SEEK A DIGNIFIED RETIREMENT COMMENSURATE WITH THE JOB WE PERFORM.

SECTION 8418 DISCUSSES AGENCY CONTRIBUTIONS BUT IT IS AMBIGUOUS. WE WOULD LIKE A CLARIFICATION ON THE ROLE OF OPM AS WELL AS USPS CONTRIBUTIONS.

SINCE I HAVE BEEN EMPHASIZING PARITY WITH THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM, THE SAME IS TRUE IN THE EMPLOYEE CONTRIBUTION AREA.

PRE-1984 EMPLOYEES CONTRIBUTE 7% TO THEIR RETIREMENT PROGRAM (CSRS). UNDER THE PROPOSED SUPPLEMENTAL, NEW HIRES WOULD CONTRIBUTE 5.8% AS OF 1986 TO RETIREMENT. TO BE CONSISTENT, THE PAYMENT BY NEW HIRES SHOULD REMAIN ON A PAR WITH CSR. ACCORDING THE STATISTICS BY THE CONGRESSIONAL RESEARCH SERVICE, IF NEW HIRES CONTRIBUTED 7% OF PAY MINUS THE AMOUNT PAID FOR OASDI THE ENTIRE RETIREMENT SYSTEM BECOMES 1.1% LESS EXPENSIVE FOR THE FEDERAL GOVERNMENT. THIS ADDITIONAL REVENUE FROM EMPLOYEES WOULD ENABLE INCREASED DEFINED BENEFITS WITH NO ADDITIONAL COST TO THE GOVERNMENT.

IN ADDRESSING SUBCHAPTER III OF TITLE I, THE THRIFT PLAN, I WOULD LIKE TO REITERATE THAT I SUPPORT THE CONCEPT. IT'S AN IDEA WHICH MODERNIZES OUR RETIREMENT SYSTEM TO KEEP US COMPETITIVE. HOWEVER, TREASURY DEPARTMENT'S STATISTICS FOR THE SPRING OF 1985 SHOW THAT IRAS MAINLY ARE UTILIZED BY HOUSEHOLDS WITH REAL INCOME LEVELS OF MORE THAN $40,000. THE AVERAGE LETTER CARRIER EARNS $23,000/YEAR.

THEREFORE, A SUPPLEMENTAL WHICH USES THRIFT SAVINGS TO MAKE IT ATTRACTIVE IS FINE. BUT ONE WHICH COUNTERPOSES A THRIFT TO IMPORTANT DEFINED BENEFITS WILL MAINLY BENEFIT THE MINORITY OF HIGHER PAID EMPLOYEES AT THE EXPENSE OF THE MAJORITY. AS I POINTED OUT EARLIER, LETTER CARRIERS CONTRIBUTING THE MAXIMUM TO THE THRIFT COULD WIND UP PAYING 15.8% OF PAY FOR RETIREMENT. IF WE DON'T PASS ANY SUPPLEMENTAL, THEY WOULD BE PAYING 12.8% (COMBINING SOCIAL SECURITY WITH CSRS PAYMENTS) AND RECEIVING MORE THAN THEY WOULD FROM THE SUPPLEMENTAL!

IN THE CASE OF S. 1527, CRS ESTIMATES THAT THE THRIFT PLAN AMOUNTS TO 6% OF THE ENTRY AGE NORMAL COST AS PERCENT OF PAYROLL. THAT MONEY COMES FROM THE POSTAL SERVICE. WE SUPPORT CUTTING-BACK ON THAT PORTION OF THE COST TO THE GOVERNMENT, WHICH WOULD BE CONSISTENT WITH THE PRIVATE SECTOR AND PRESIDENT REAGAN'S TREASURY II PROPOSAL. WE WOULD LIKE MORE MONEY IN DEFINED BENEFITS AND ARE EXAMINING AVAILABLE OPTIONS, SUCH AS A 50% MATCH ON CONTRIBUTIONS UP TO 6% OR A 100% MATCH ON 3% CONTRIBUTION.

SUBCHAPTER IV, TITLE I DESCRIBES THE BENEFITS AVAILABLE TO SURVIVORS OF DECEASED PARTICIPANTS AND FORMER PARTICIPANTS.

THE WELL-BEING OF A SPOUSE IS IMPORTANT TO LETTER CARRIERS. IN ORDER TO RECEIVE SURVIVOR BENEFITS, RETIREES PAY APPROXIMATELY 10% OF THEIR ANNUITY YEARLY.

S. 1527 CHANGES THE BENEFITS FOR PRERETIREMENT SURVIVING SPOUSE FROM 55% OF THE UNREDUCED ANNUITY TO 50% OF THE REDUCED ANNUITY OF THE EMPLOYEE'S PENSION (PLUS ANY SOCIAL SECURITY BENEFITS PAYABLE). FURTHERMORE, BENEFITS CAN NOT BE COLLECTED BEFORE THE DATE AT WHICH THE LETTER CARRIER COULD HAVE RETIRED.

IN THE CASE OF A 42-YEAR OLD WIDOW WHOSE HUSBAND DIED AT AGE 45, SHE WOULD NOT BE ABLE TO COLLECT SUPPLEMENTAL BENEFITS UNTIL SHE REACHED AGE 52. THIS IS A DRASTIC CHANGE FROM CURRENT CIVIL SERVICE RETIREMENT SYSTEM WHICH HAS NO AGE REQUIREMENT. SHE WOULD COLLECT SOCIAL SECURITY IF HER HUSBAND QUALIFIED, BUT HER COMBINED ANNUITY WOULD BE BELOW THE POVERTY LINE.

FOR SURVIVING SPOUSES OF RETIRED CARRIERS, S. 1527 DIMINISHES THE ANNUITY FROM THE CURRENT CSRS LEVEL OF 55% OF THE UNREDUCED ANNUITY TO 50% OF THE REDUCED ANNUITY MINUS ANY SOCIAL SECURITY PAYMENTS.

IN MONETARY TERMS, S. 1527 PROVIDES THE SPOUSE SURVIVOR OF A LETTER CARRIER WITH 10 YEARS SERVICE WHO DIED AT AGE 45 $56/MONTH, AND IT WOULD NOT BE PAID FOR 10 YEARS. WE CAN NOT SUPPORT THIS CHANGE OR THE TOTAL ELIMINATION OF CHILDREN AND STUDENT SURVIVOR BENEFITS. THE MAJORITY OF SPOUSE SURVIVORS ARE WOMEN OVER AGE 45. IT PUTS THEM BELOW THE FAMILY POVERTY LEVEL AND IN AN ALMOST IMPOSSIBLE POSITION: THEY MUST FIND WORK AT AN AGE WHEN MANY EMPLOYERS WILL NOT EVEN GIVE THEM A

FAIR CHANCE. IT INSTITUTIONALIZES THE ABYSMAL SITUATION TERMED THE "FEMINIZATION OF POVERTY" WHEREIN ONE OF THE POOREST STATISTICAL GROUPINGS IN AMERICA TODAY IS ELDERLY WOMEN.

THE SAVINGS FOR THE GOVERNMENT HERE ARE MINIMAL, YET THE HARDSHIPS CREATED ARE MAXIMUM. IN EITHER THE PRE-RETIREMENT OR RETIREMENT CASE, IT WOULD BE MORE ACCEPTABLE TO REINSTATE THE FORMULA USED BY THE CSRS.

ON THE TOPIC OF DISABILITY RETIREMENT (SUBCHAPTER V, TITLE I), WE FULLY CONCUR WITH THE ELIGIBILITY PERIOD OF 18 MONTHS. HOWEVER, THERE ARE AREAS WHERE WE HAVE DIFFERENCES.

ONE OF THOSE IS SECTION 8446, WHICH ALLOWS THE USPS TO OFFER OTHER CRAFT EMPLOYMENT IN LIEU OF RETIREMENT. WE WRESTLED WITH THIS PROBLEM IN 1969 AND 1970 DURING DISCUSSION OF THE POSTAL REORGANIZATION ACT. CONGRESS DECIDED THAT IT WOULD BE A BAD POLICY. IT CAME UP AGAIN IN 1981 AS PART OF THE "GRAMM-LATTA" BUDGET. ONCE AGAIN, HOUSE-SENATE CONFEREES AGREED THAT IT WAS DISRUPTIVE TO THE POSTAL SERVICE BECAUSE IT BLURS JOB DISTINCTIONS IN THE POSTAL SERVICE AND WOULD CREATE HAVOC.

FOR EXAMPLE, A LETTER CARRIER WHO IS IMMOBILIZED IS PUT INTO A CLERK'S POSITION. WHO HAS SENIORITY AND WHAT

LEVEL/STEP RATE IS USED? WHAT IS THE WAGE RATE? DOES THE CARRIER NEED TO TAKE AN EXAMINATION? I CAN FORESEE FROM THE EXPERIENCE OF OTHER UNIONS A SITUATION OF ENDLESS, COSTLY GRIEVANCES AND LAWSUITS AND DISGRUNTLED EMPLOYEES WHO SEE BETTER PAYING JOBS OR CHANCES FOR ADVANCEMENT TAKEN AWAY. OR, YOU MAY PUT LETTER CARRIERS IN THE POSITION OF DOING CLERKS' WORK, A SITUATION WHICH IS DETRIMENTAL TO THE EFFICIENCY OF THE EMPLOYEE AND THE POSTAL SERVICE.

THE COMPULSORY MEDICAL EVALUATION SECTION IS NOT CLEAR. SHOULD A RETIREE BE FOUND TO BE NO LONGER DISABLED, WHAT RESPONSIBILITIES DOES THE USPS HAVE IN FINDING A JOB, FOR EXAMPLE.

SECTION 8450 ESTABLISHES AN EMPLOYEES' DISABILITY INSURANCE FUND IN THE U.S. TREASURY AND REQUIRES AGENCIES TO MAKE PAYMENTS TO THE FUND FROM SALARY APPROPRIATIONS. HOWEVER, A THIRD PARTY WOULD ADMINISTER PAYMENTS. THIS WOULD ADD EXPENSIVE, PRIVATE-SECTOR PARTICIPATION RATHER THAN CONTINUING THE CURRENT OPM OPERATION. THE POTENTIAL FOR CONFUSION AND ENTANGLED PAPERWORK IS ENHANCED.

IN THE STEVENS-ROTH BILL, LETTER CARRIERS COVERED UNDER THE PRESENT CIVIL SERVICE RETIREMENT SYSTEM CAN TRANSFER TO THE NEW SYSTEM. WE AGREE THAT BOTH SYSTEMS NEED TO BE FINANCIALLY SOUND AND UNDER ONE ROOF. HOWEVER, WHEN A SYSTEM AS COMPLEX AS THIS SUPPLEMENTAL IS STARTED, IT SEEMS PRUDENT TO WAIT FOR A COUPLE YEARS TO SEE WHAT PROBLEMS

APPEAR. NO MATTER HOW MUCH WE TRY TO HEAD-OFF TROUBLE, WE KNOW THAT WE CAN NOT PREDICT ALL POSSIBLE PROBLEMS.

I'D LIKE TO CITE AN EXAMPLE FOR YOU. RECENTLY THE STATE OF MARYLAND ADOPTED A NEW RETIREMENT SYSTEM FOR ITS EMPLOYEES. MARYLAND ALLOWED EMPLOYEES COVERED UNDER THE PREVIOUS SYSTEM THE OPTION OF TRANSFERRING. THERE WAS AN IMMEDIATE RUSH TO TRANSFER, WHICH IN ITSELF CAUSED PANIC AND CONFUSION. THEN, WHEN PEOPLE REALIZED WHAT THE "SMALL PRINT" CHANGES WERE, THEY RUSHED TO CHANGE BACK. THE RESULT WAS A NIGHTMARE.

IN ADDITION, THERE WOULD BE LEGISLATIVE CONSIDERATIONS INVOLVED IN OPENING UP THE SOCIAL SECURITY ACT. TRANSFERS RAISES THE POSSIBILITY OF THE SENATE FINANCE COMMITTEE SHARING JURISDICTION WITH GOVERNMENTAL AFFAIRS ON S. 1527.

WE SHOULD WAIT A COUPLE YEARS, EXAMINE THE MYRIAD OF PROBLEMS INVOLVED IN TRANSFERS, AND THEN PROCEED CAUTIOUSLY.

ONE OMISSION FROM THIS BILL: HOW TO HANDLE THE PROBLEM OF RE-HIRES. HOW DOES THE SUPPLEMENTAL PLAN HANDLE SOMEONE WHO HAS PREVIOUS SERVICE IN THE GOVERNMENT AND HAS CONTRIBUTED TO THE CIVIL SERVICE RETIREMENT PLAN BUT HAS BEEN REHIRED AS A NEW EMPLOYEE AND WILL BE COVERED BY THE NEW SUPPLEMENTAL PLAN? THE BILL DOES NOT ADDRESS THIS ISSUE AND IT WILL BE AN IMPORTANT ISSUE FOR A LARGE NUMBER OF GOVERNMENT EMPLOYEES, SOME OF WHOM ARE ALREADY IN THE EMPLOY OF THE GOVERNMENT. IN CERTAIN CASES, SOME OF THESE INDIVIDUALS ARE VESTED IN THE CSRS.

AS YOU CAN SEE MR. CHAIRMAN, THERE ARE AREAS WHERE WE BELIEVE BENEFITS MUST BE RESTORED TO CURRENT LEVELS AND IMPROVED. AND THERE ARE AREAS WHERE WE THINK LETTER CARRIERS CAN GIVE MORE. IF YOU HAVE ANY QUESTIONS, I WILL BE GLAD TO ANSWER THEM.

THANK YOU.

TESTIMONY

OF

TOM W. GRIFFITH, PRESIDENT

NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

ON

S. 1527

THE CIVIL SERVICE PENSION REFORM ACT

September 10, 1985

Mr. Chairman and Members of the Committee:

My name is Tom W. Griffith. I am the President of the 66,000-member National Rural Letter Carriers' Association. Rural letter carriers serve fifteen million American families by daily traveling 2,387,951 miles over 38,925 rural routes throughout these United States. We are honored to appear before the Committee on Governmental Affairs and to offer our testimony on your bill. We are grateful for your dedication and diligence in mastering the complexities of developing a new retirement system.

We compliment you on the series of pension forums. They were unique and educational. They provided a good opportunity to bring forth diverse information. We appreciate you and your staff's great effort and continuing work on this subject as you and the Members of this Committee attempt to write legislation for our new retirement system.

Let us, for the record, say that it is our desire to see a bill passed into law this year. But, if it takes slightly longer, then let's not sacrifice quality for haste.

We think your basic design is a good one, and you are to be commended for it. It is like an automobile. And, like even a fine automobile, from time to time, they require some fine tuning. In no way do we think that the basic design must be scrapped at all. We like the basic design and appreciate the effort that you and your staff have put into it, but we would like to see it fine-tuned.

I will attempt to outline those areas of the plan which we are particularly pleased with, and those areas in which we think there could be some fine-tuning to improve your bill.

We view the program as consisting of three tiers, the first of which is Social Security. As we all know, there is a tilt to Social Security.

The second tier is the defined benefit portion. We are pleased with your add-on approach, because the tilt favors lower salaried employees and can be offset by a voluntary supplemental capital accumulation plan. Any offset would concentrate benefits on the higher paid workers in the system and lesser benefits to the lower paid employees. By your simple add-on plan, the Federal Government would be setting a good example for private employers. Higher paid employees have much greater disposable income and, therefore, have the ability, through their own savings initiative, to compensate for the Social Security tilt.

Employee Contributions - We think the employee contribution level should roughly equal current contributions to the Civil Service Retirement System. Currently, employees pay 7% of their salary, plus 1.35% for Medicare. Employees, under the system which the Committee is now designing, will pay, by 1990, 6.2% Social Security. We recommend that employees contribute to the defined benefit program in an amount which will provide equal contributions between the existing plan and the proposed plan.

There is historical precedence for public employees' participation in contributory staff retirement systems. We realize that in the forums, it was pointed out that private sector retirement systems are largely non-contributory. However, those corporations have an entirely different mission compared to the Government. They are organized for, and have a responsibility to their shareholders to make a profit. That is not our Government's function. Private business also receives a tax deduction for their contributions to a retirement plan. The Government obviously cannot. We believe employee contributions give a certain amount of budgetary flexibility to the rest of the Federal Budget and may prevent the temptation of a future Congress to alter the plan, after you have adopted it. Simply stated, a plan in which the employees have a direct stake in funding will discourage legislative tampering in the future.

The accrual rate in the defined benefit plan should be increased and be more generous. There should be a reward for longer service at a higher accrual rate than for early employment.

We approve of most of the vesting schedule, with the exception of the penalty for early retirement. We would like to see the bill changed so employees would have the ability to retire after 30 years of service at 55 years of age without any penalty. We propose that employees who would be interested in that early retirement option could contribute an additional amount to this optional program. The program would be a portion of the defined benefit plan and the employee would have to opt early in their service career to pay an additional contribution, with a Government match, to the defined benefit plan and have the ability to retire at 55 years of age with 30 years of service without penalty. In effect, the employee would have the option to purchase the right for early retirement.

Computation - We support High-3 instead of High-5 salary base for benefit computation.

We believe in the funding adequacy of the current system. And, we would hope that the funding mechanism in this new system protects it from political manipulations. We appreciate the fact that, in your bill, all funds from the defined benefit program would flow into the existing Civil Service Retirement Fund, which will protect its assets in perpetuity for all who will be retiring under the old system.

Cost Of Living Adjustments should be fully indexed. The formula should be the same as now exists under the current Civil Service Retirement law. We noted from the charts done by Congressional Research Service that a retiree, even with a capital accumulation plan, looking at the amount of wages that his pension replaces, has that go down as much as 20 points from the time of their retirement until approximately age 75. Frankly, we find that a difficult concept to accept. The Federal Government has been, and should continue to be, a morale force in the work place - a precedent setter. When Government has a fully indexed COLA, it sets an example. The testimony at the forums pointed out that most private employers do not have a cost-of-living adjustment provision. However, most of them, at least make ad hoc adjustments every three to five years. We feel the reason for those ad hoc adjustments is the pressure that the Federal Government has brought in the work place by having fully indexed COLAs. It is a very positive example that the Federal Government has set and it should continue. When there is a modest reduction in the capital accumulation section, along with an employee contribution, then the COLA program should continue as it exists in the current system with virtually no increase in cost.

Recently, the President amended his tax reform plan to urge repeal of the (401)-K tax-shelter capability. His proposal gives us cause for concern about the capital accumulation plan in this bill. Loss of tax deferral would be a significant loss to employees. We certainly urge retention of this tax benefit.

With regard to the savings portion, we compliment you for your innovation and flexibility in the design of this section. From the standpoint of our particular membership, however, we would like to point out to the Chairman and Members of this Committee several reasons why we prefer slightly less emphasis on savings and a little more on defined benefit. A rural letter carrier starts out at about $17,000.00 a year. The average rural carrier, at the top of their career, is making about $26,000.00 a year. In those pay ranges, few of our members will be financially able to participate in a voluntary savings program early in their lives as they buy their first residence, as they have the first additions to their families, and, as their children grow up, the expenses of a family will come first. Savings, unfortunately, will probably take a back seat to these things for most rural carriers.

However, when the children are finally out of the nest, then our suspect is that they will begin to consider retirement. We would suspect that they will participate in the capital accumulation plan. However, when it is done later in life, rather than consistently throughout a career, the total benefit is much smaller compared to that when the employee has participated throughout an entire career.

For in a savings capital accumulation plan, compounding is what really builds it. A relatively short period of savings will simply not build a large nest egg going into retirement.

Voluntary savings by an employee should be allowed up to 10% of their pay. The Government's one-for-one match should be limited to 3% of salary. The 5% proposed in the bill is unnecessarily generous and too costly.

Mr. Chairman, again, we offer our appreciation to you and your hard-working staff for the care and concern you have shown in the process of developing this very fine piece of legislation, which, with the fine-tuning we have suggested, we could easily support. We look forward to continuing to work with you on this complicated issue and appreciate your interest and concern about an adequate retirement program for new rural carriers.

Senator GORE. Our next witness is Paul S. Hewitt, president and executive director of Americans for Generational Equity, accompanied by Phillip Longman, director of research.

Let me say before we begin that Senator Durenberger has made a special point of advising this committee to listen carefully and closely to your testimony, Mr. Hewitt. You are from Minnesota, if I am not mistaken, is that correct?

Mr. HEWITT. Senator, as a matter of fact, I am from California, but I did work for the Senator from Minnesota.

Senator GORE. That is the connection, and I also believe he had a hand in helping to get this effort started. Anyway, I wanted to note for the record that he has a special interest in this and had wanted to be here to introduce you but other obligations at the last moment prevented that.

Your prepared statement will be included in full in the record. If you could summarize where appropriate, that would be most appreciated. Please proceed.

TESTIMONY OF PAUL S. HEWITT, PRESIDENT AND EXECUTIVE DIRECTOR, AMERICANS FOR GENERATIONAL EQUITY, ACCOMPANIED BY PHILLIP LONGMAN, DIRECTOR OF RESEARCH

Mr. HEWITT. Thank you.

My name is Paul Hewitt and I am president and executive director for Americans for Generational Equity. Seated next to me is Phillip Longman, director of research.

Americans for Generational Equity was recently formed under the bipartisan leadership of Senator Dave Durenberger and Representative James R. Jones to speak out on issues affecting the economic prospects of younger and future generations of Americans.

I am particularly pleased to be able to testify on this bill, Mr. Chairman, which I regard as probably one of the most important bills the committee will take up in this decade. My purpose today is to outline the long-term public interest in the design of this and other Federal retirement programs; to cast the committee's efforts in the broadest possible perspectives and to encourage policy development in terms of what we now know about the future.

I will start by articulating two principles of generational equity that should guide the design of any new Federal pension system.

First, the Congress should seek to minimize any unfunded liabilities under this system and, second, that it adopt compensation policies that efficiently attract competent employees to Government.

With regard to the first principle, I would point out that the only difference between increasing an unfunded liability and increasing the national debt is that the Constitution permits future taxpayers to break our retirement promises to future retirees, whereas the Constitution requires the future Congresses to pay off the national debt. However, assuming our retirement promises are honored, then there is no difference. Both unfunded liabilities and the national debt constitute IOU's that must be repaid by future taxpayers. Accordingly both should be viewed with caution.

Mr. Chairman, few realize that under the civil service retirement system, the unfunded liability right now totals almost a third of the national debt. Last year the Office of Personnel Management estimated the unfunded liability at $542 billion, even though the civil servants who are going to be covered in this legislation were not included in that computation. This bill as it stands will significantly increase the system's unfunded liability once enacted.

The question before this committee is how much should we increase the debt of future taxpayers. In deciding this question, the committee should consider the fact that future taxpayers may not be able to keep the promises that this committee makes. When CSRS was last overhauled in the 1960's, great optimism prevailed about the future taxpayers' ability to absorb growth in the CSRS trust fund liabilities. Incomes and living standards had been going up for about two decades. This fact probably helps to explain the richness in the current system.

Legislative history shows the debate in 1969 was over how to stem short-term budget surpluses. Future income growth was taken for granted. Today it is clear that we probably should have been more prudent. We now have great reason to be pessimistic about the economic prospect of future taxpayers.

For example, consider that today we are leaving our children with a national debt that is 10 times that which existed following World War II. Representative John Porter, working with the Congressional Research Service, recently estimated that the average worker entering the workforce in the year 1990 will end up paying $100,000 in taxes over his or her lifetime to pay the interest on the material debt in existence in that year. Mind you, this is a conservative estimate. It assumes only 6-percent interest rate and no growth in the debt after the year 1990. Similarly we have estimated today's young workers each stand to pay an additional $10,000 in interest just to service this year's deficit.

Future taxpayers are also going to have to pay off a gigantic unfunded liability in the Social Security System which now totals 3.5 times the amount of the national debt. This system is supposed to be accumulating a cash surplus that will fund the baby-boom generation's retirement. In fact, the money is not going to be there because the Treasury is borrowing it and using it to pay for current expenses. Consequently, we are leaving the trust fund with a surplus that consists only of IOU's between future taxpayers and retirees. So, as it now stands, future taxpayers will be stuck with the baby boom's entire Medicare and Social Security bill which will have to be funded probably through a series of future tax increases beginning, under optimistic scenarios, around the year 2020.

Moreover, Mr. Chairman, unlike during the 1960's, the trend in personal income in this country is downward. Upward mobility is no longer the general rule in American society. Since 1972, workers' incomes have declined across the board. And they have de~~clined the~~ most for the young who will inherit our debts and unfunded liabilities. Between 1972 and 1983, for example, households headed by persons age 25 to 34 suffered a 19-percent decline in their real, after-tax income.

Finally, an examination of the poverty rate for children suggests that downward mobility is only in its infancy stages. Demographers now estimate one out of three children born today will experience poverty before reaching the age of 18. Poor youths tend to grow into poor adults. This suggests there will be a large underclass in the early 21st century and, at the very least, we can anticipate that a very large segment of future workers in this country will not be able to afford the kind of taxes that will be needed to finance the rapidly accumulating debts and unfunded liabilities that will be coming due at that time.

All of this serves to point out we should indeed be very cautious in creating new unfunded liabilities for which future taxpayers will be billed.

My second principle—that is, efficiently attracting competent Federal employees to the work force—relates to a basic CSRS goal. Yet, the current Federal compensation structure is a failure in this regard, and CSRS is part of the problem. High retirement benefits are, in fact, a very inefficient and uneconomical way to attract top quality employees. The evidence is overwhelming that employees are attracted to high pay not high retirement benefits.

But, for obvious reasons, Congress prefers paying later than today. Future taxpayers are always more compliant than present ones. The consequence of all this is the Congress has saddled the Government with a compensation structure that is increasingly skewed toward what we call deferred compensation. Studies show that total Federal compensation, including retirement benefits, health benefits, and pay, is roughly on par with that paid by the better private-sector firms. Yet pay is significantly lower, while retirement benefits are significantly higher in order to compensate. This suggests that Federal policy is geared more toward retaining than attracting employees. And the result is the employees we are retaining may not be the best ones available.

The result may also be that as a legacy for our children, we are systematically creating a less efficient, less creative work force. The result will be more heavy handed regulation, more $9,000 Allen wrenches, and fewer imaginative solutions to the many challenges facing Government.

Unfortunately, S. 1527 is far from satisfying these principles. Yet it represents a major and perhaps historic step in the direction of intergenerational fairness and fiscal responsibility. Its main principal innovation is the thrift plan under subchapter III. This plan envisions that up to 22 percent of the employer's total retirement contributions will be deposited in employee-owned accounts in the private sector, when matched by a like amount of employee savings. This will lead us toward the funding of a large portion of the Federal Government's pension liability in advance. We will move away from the practice of financing all retirement benefits with unfunded liabilities.

In addition, by encouraging employee savings, the plan would stimulate capital formation and investments in the kind of competitive technologies that future workers are going to need to be able to generate the wealth to finance the baby boom's retirement.

My major criticism of the bill is that it only creates modest savings—16.8 percent under the cost of the current system. At 20.8 percent of payroll, the plan is still about 2 percent of payroll higher than the richer private sector plans and in fact these may leave retirement benefits too high to permit the Government to afford the kind of meaningful pay reform that may be needed to eventually get the Government back into competition with the private sector for the best potential employees.

By itself, S. 1527 is not enough to restore generational equity to the Federal pension system. We must solve the deficit problem first and foremost, for it is certainly not fair or wise to advance fund one segment of Government with borrowing from another. Accordingly, I commend, the sponsors for their 10-year transition period for phasing in the advance funding of the savings plan. This period will allow the Federal Government to get its fiscal house in order. This bill creates a much fairer compensation structure. Once the Federal budget is finally balanced, it may serve as a guide to the later reform of military and Social Security programs.

In conclusion, while a number of changes may be necessary to the bill, the thrift plan in S. 1527 is a long overdue idea and should be expanded not curtailed. Employees should embrace the plan. Their benefits will be safer and place less of a burden on their children. It may cost taxpayers more in the short run, but will lend fiscal discipline to the compensation structure and make paying later somewhat less attractive.

Thank you, Mr. Chairman, this concludes my comments.

Senator GORE. Thank you very much for your statement. It is a real contribution to our deliberations here. You said toward the end of your statement that the Stevens-Roth plan is still about 2 percent of payroll higher than the better private sector plans. I believe it might be accurate to say it's 2 percent higher than the average of all private sector plans, but the larger employers, with whom many believe the Federal work force should be compared, have plans significantly higher in payroll costs than the Stevens-Roth plan. So I am a little unclear as to what you mean by saying that it's 2 percent higher than the better private sector plans.

Mr. HEWITT. I assume the average is probably an average of the Fortune 500 companies.

Senator GORE. It is the average of all. It is average of medium and large-size firms.

Mr. HEWITT. Yes.

Senator GORE. Should we change that in your statement?

Mr. HEWITT. Fine.

Senator GORE. You can comment further on it for the record. You don't disagree with the findings of the GAO or Hay Associates that I referred to a moment ago about the larger employers?

Mr. HEWITT. No; I was mistaken in my testimony.

Senator GORE. Has your group addressed the question of Federal wages?

Mr. HEWITT. No, but I think eventually we are going to have to get around to putting the Federal Government in the position where it can compete with the private sector for the best employees. My sense is that this is most economically done through pay rather than retirement benefits.

Senator GORE. You wish to be intellectually consistent and support higher wages for the Federal workforce?

Mr. HEWITT. Certainly, in some though not all cases. The freezing of pay over a period of years has decreased Federal salaries significantly over time. Some Federal employers are underpaid.

Senator GORE. Incidentally, I think your organization's voice is one that plays a very useful role in articulating a set of concerns that need to be voiced. Some of the statements that you made, I was looking for one here where you say—oh, yes, you refer to the Social Security System, and I will digress here briefly because you did raise this—saying, "Although Social Security is supposed to be accumulating a surplus that will finance the baby boom generation's retirement, the money is not going to be there."

Are you sure about that?

Mr. HEWITT. I suppose Congress can change the law, but under current law, it is not going to be there. We are pretty much constrained to investing the surpluses in Treasury debt obligation.

Senator GORE. You are leaping to the conclusion that when the government borrows that money, it is going to refuse to pay it back.

Mr. HEWITT. No; I'm not saying that. I am saying when we take the surpluses that we put in there so that they are not cash surpluses but exist only in forms of IOU's for future taxpayers and retirees, the future taxpayers are going to have to pay them. Around the year 2020, under the optimistic scenario, Social Security is going to stop running a surplus. The contributions will be less than the payouts under the system. In that case, we have to turn to the taxpayer at that time and say, OK, pay up.

The Treasury has four options. It can cut the benefits and say the taxpayers can't pay up. It can raise taxes. It can spend less money on other things. There are a number of options. Eventually under a pay-as-you-go system, the taxpayers at that point in time pick up the bill. The problem under Social Security, and the reason it is going to stop running a surplus, is the demographic factors. There are about three and a half workers——

Senator GORE [interposing]. Three point two.

Mr. HEWITT. I understand it is a little bit higher. It is going to shrink down in 2035 to 1.9 and this will cause us to go back to the existing tax base and have to raise more money because we did not accumulate *x* surplus.

Senator GORE. I understand your logic, but the basic problem you are getting at there is the deficit and the practice of the Government of borrowing $500 million a day at the present time, which I certainly agree with you is ridiculous. But the Government is going to borrow that money from somewhere and if it borrows from the Social Security surplus, it is going to pay it back to the Social Security surplus. It is a kind of a technical point, but I do think that we need to be careful, particularly an organization like yours which is a needed voice in this debate. I think you have got to be very careful in making the flat statement to members of our generation that the money is not going to be there for Social Security.

I think the statement is false.

Mr. HEWITT. The cash won't be there, Senator. Maybe the money will—I think the point I am trying to make is that these future taxpayers who are coming along are going to have to bear significant tax increases in order to fund these unfunded liabilities.

Senator GORE. As I say, I appreciate the voice you bring to this debate. I may submit some additional questions in writing. I appreciate the chance to hear you. Thank you, Mr. Chairman.

Senator **Stevens** [presiding]. I regret I had to be called to a meeting over in the leader's office while you were presenting your statement. I have looked through it and my staff tells me it is a very interesting analysis of the problems that we have.

The problem I have with the analysis is that I don't think it looks at the tradeoffs. Congress has, in fact, done what you have suggested. It has traded off commitments for security upon retirement for cash payments in terms of trading Government salaries to the marketplace now. If we accept your advice, we would have no alternative, would we, but to try to raise the salaries immediately and that would offset the savings, wouldn't it?

Mr. **Hewitt**. I am not saying you just plain raise salaries, but I think there are certain cases where we are going to have to need to take a look at what good people are being paid in the private sector and compensate our employees accordingly. My point is, if you are going to try to attract good people to the Federal Government, the least efficient way to do it is by offering them retirement benefits. If you are going to attract good people to Government, what you want to do is spend your money most efficiently. That may be on pay. That puts you in the tradeoff with the deficit.

From a broader standpoint, Senator, there is a real question about the competence of the civil service. In the educational system, we all heard something about the baby boom coming through and there was a teacher glut for a number of years and the market system forced down wages of teachers for a long time. One consequence of that was promising young students stayed away from the teaching profession. Today the average teacher has a SAT score 104 points below the average of all other college graduates. If you want that to happen in the Federal Government, the consequence may be more heavyhanded, unimaginative Government action and less creative solutions.

I just point that out as one of the legacies we can be leaving the next generation if we systematically allow pay to erode while trying to attract people with high retirement benefits.

Senator **Stevens**. What do you think of our investment plan to put the money in the private sector?

Mr. **Hewitt**. I think it sets the system itself on a much fairer course from the standpoint of future versus present taxpayers. Right now our compensation system is heavily skewed toward retirement benefits. That means we are asking future taxpayers to pick up the bill. I think it would be fair and make us a little more indifferent between pay and retirement benefits if we started funding some of the retirement benefits today.

Senator **Stevens**. As Senator Gore says, here is a voice I am sure we are going to hear again and again. We appreciate your articulating the position you represent. Thank you very much.

[Mr. Hewitt's prepared statement follows:]

TESTIMONY OF PAUL S. HEWITT
PRESIDENT, AMERICANS FOR GENERATIONAL EQUITY
ON S. 1527, THE CIVIL SERVICE PENSION REFORM ACT
BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
SEPTERMBER 9, 1985

My name is Paul Hewitt, and I am the President and Executive Director of Americans for Generational Equity. I appreciate this opportunity to testify before the Governmental Affairs Committee on the Civil Service Pension Reform Act, a bill with major long-term consequences for the economy. Accompanying me is Phillip Longman, AGE's Director of Research.

Americans for Generational Equity was recently formed under the bipartisan leadership of Senator Dave Durenberger and Representative James R. Jones to speak out on issues affecting the economic prospects of younger and future generations of Americans.

Our concern is that many of the policies and decisions made today have ramifications far into the future. But, invariably, the young people who are most affected by them go largely unrepresented in the policy making process. The legislation now before this Committee is an excellent case in point. The vast majority of those whose future benefits are being established through the Committee's efforts will have little say in their definition.

Similarly, the future taxpayers who ultimately will be called upon to finance these benefits are also unrepresented.

I am here today primarily to speak for the second of these two groups. While I will touch upon issues of special interest to future civil service retirees, my principal goal is to provide an assessment of the long-term public interest in the design of this and other government retirement programs, and to frame the Committee's efforts in the broadest possible perspective.

Principles

Mr. Chairman, I would like to begin by outlining two basic principles that I believe should guide the design of a new Civil Service Retirement System: (1) minimizing the system's unfunded liabilities; and (2) efficiently attracting and retaining competent employees.

1. Minimize the Creation of New Unfunded Liabilities.

The first, and most important principle is that new unfunded liabilities under the Civil Service Retirement System should be minimized. As the Chairman has observed many times in the past, creating an unfunded liability is tantamount to expanding the national debt.

In fact, the only real distinction between adding to CSRS' unfunded liability and increasing the national debt is that the Constitution obliges future congresses to honor the nation's debts; whereas, it prevents the promises of this congress from binding future congresses. However, assuming that future taxpayers do keep today's promises to future retirees, both unfunded liabilities and the national debt comprise money that must come out of the pockets of future taxpayers. Accordingly, both should be viewed with an equal degree of caution.

While the issue of federal borrowing crowds the nation's headlines, few realize that the unfunded liability of the CSRS trust fund alone is equal to almost a third of the official national debt. The Office of Personnel Management estimated last year that the system's unfunded liability as of September 30, 1984, was $542 billion. Its rate of increase -- $13 billion in the year since September 30, 1983 -- had slowed from prior years, because federal workers hired after December 31, 1983 were not covered under CSRS. However, when Congress defines the entitlements of these new workers, the unfunded liability will jump significantly. The only question is by how much.

In deciding this question, the Committee should consider the fact that future taxpayers may not be able to keep our promises. In the early 1960's, when CSRS was last overhauled, Americans were very optimistic about the income prospects of future taxpayers.

That in large part explains why we now have such a generous federal retirement system. But today, we have every reason to be prudent in assessing future taxpayers' prospects.

Consider that we are leaving today's children with a national debt that, after adjusting for inflation, is ten times the amount that existed following World War II. Working with the Congressional Research Service, Representative John Porter recently estimated that a person entering the workforce in 1990 will pay an average of $100,000 in taxes over his or her lifetime to service the interest on the national debt--a conservative estimate that assumes only 6 percent interest rates and no further growth in the debt. Similarly, we estimate that today's average young workers each stand to pay an extra $10,000 in taxes over their lives to service the interest on just this year's deficit.

Consider also that future taxpayers will have to pay off the gigantic unfunded liability of the Social Security system, which totals almost three and one-half times the national debt. Although Social Security is supposed to be accumulating a surplus that will finance the Baby Boom generation's retirement, the money is not going to be there. The Treasury is borrowing it to meet current expenses, leaving only IOU's between future taxpayers and future retirees. As a result, future workers -- whose ratio to the the retired population will be much lower than it is now -- must foot the full bill for the Baby Boom's Social Security and Medicare benefits--most likely through a series of large tax increases, beginning about 2020 under optimistic actuarial assumptions.

Mr. Chairman, unlike the 1960's, the current trend in personal income is downward; upward mobility is no longer a general phenomenon. Since 1972, the incomes of U.S. workers have declined across the board. But the drop has been greatest among the young, who will inherit today's unfunded liabilities. Between 1973 and 1983, for example, the real, after-tax incomes of households headed by persons age 25-34 declined almost 19 percent.

Finally, an examination of the poverty rate among today's young children suggests that the trend toward downward mobility is only beginning. Demographers estimate that one in three children born this year will experience poverty at some time before reaching the age of 18. Because poor youths tend to become poor adults, we can anticipate that a very large underclass will compete for the tax dollars of working Americans well into the next century. At the very least, we can expect that many future taxpayers will not be wealthy enough to afford the high tax rates needed to pay the nation's rapidly accumulating bills.

The upshot, Mr. Chairman, is that the consciencious development of federal pension policy must anticipate the distinct possibility that future taxpayers will either be unable, or unwilling to support large unfunded federal pension liabilities.

Indeed, the bigger the unfunded liabilities we create, the greater is the liklihood that our promises will be broken. Clearly, such apparent generosity would be neither compassionate to civil servants nor consistent with the long-term public interest.

2. Efficiently Attract and Retain Competent Employees.

My second principle relates to the efficient accomplishment of a basic CSRS goal: to attract and retain competent employees. The current federal compensation structure is a failure in this regard, and current retirement policies are part of the problem. Today's high retirement benefits are neither the best, nor the most economical means of accomplishing this goal.

To prove my point, I would refer you to the testimony of the many public employee groups who are objecting to S. 1527's Thrift Savings plan on the grounds that many employees will not take full advantage of it. They know that employees prefer pay today to future retirement benefits. Indeed, experience tells us that the best way to attract highly qualified employees is through high pay, not retirement benefits.

Yet, for obvious reasons, Congress has a clear preference for paying later, rather than now. For one thing, future taxpayers are much more compliant than present ones. For another, unfunded liabilities will not show up on this year's budget. As a consequence, the government has saddled itself with a compensation structure that is increasingly skewed toward "deferred compensation."

While studies consistently show that total federal compensation -- including pay, health benefits and retirement -- is roughly on par with that provided by large private sector firms, they also show that pay tends to be significantly lower, while retirement benefits compensate by being significantly higher. Under this structure, however, federal compensation policy is geared less toward attracting good employees than retaining the ones we have. It is discomforting to note that the employees who are being retained are those we have attracted with substandard pay; they are probably not the best available.

The legacy of such an approach is chilling. Mr. Chairman, we are systematically creating a less efficient, less creative, and less motivated workforce to carry out federal programs. And the consequence for America's future is that there will be more heavy-handed regulation, more $9,000 allen wrenches, and fewer imaginative solutions to the many challenges facing government.

In short, I would conclude that the current federal compensation policy does a double injustice to future taxpayers. Not only does it contemplate that they will pay the lion's share of the cost of compensating today's civil servants through "deferred compensation." It guarantees that they will be served by a less-qualified workforce than could have been recruited had today's taxpayers been willing to shoulder their fair share of the compensation burden.

Analysis of Legislation

In analyzing the Civil Service Pension Reform Act (S. 1527), one is tempted to say that the glass is half-empty. Clearly, the bill is a long way from accommodating the principles of generational equity. Yet, compared with the current retirement system, this legislation represents a major step in the direction of intergenerational fairness and fiscal responsibility.

I recognize that the provisions in S. 1527 that I consider the most desirable are controversial among the powerful special interest groups who would have us replicate the current CSRS in order to justify the unrealistic promises made to current employees. I also recognize that these provisions compete with the important short-term goals of deficit reduction and avoiding unnecessary tax increases. For this, I commend the bill's sponsors for their courage and foresight.

The principal innovation of S. 1527 is its Thrift Savings plan, under subchapter III. This plan envisions that up to 22 percent of the employer's total retirement contributions will be placed in employee-owned accounts in the private sector, when matched by a like amount of employee savings. By so doing, the federal government would be funding a substantial portion of its pension liabilities in advance. The effect would be to move away from the current system of financing all retirement benefits with unfunded liabilities, which are nothing more than IOU's from future taxpayers to future retirees. This approach is much fairer to future taxpayers.

In addition, by encouraging employee saving, the plan would stimulate capital formation and investment in the world competitive technologies that future workers will require, if they are to finance the Baby Boom generation's retirement.

S. 1527 envisions the full advance funding of the Thrift Savings plan but plans to phase it in over a ten-year period. Such a transition may well be necessary in light of the federal government's need to get its fiscal house in order in the meantime. Advance funding means that today's taxpayers must shoulder a greater share of the burden for the retirement of today's civil servants. This costs money, and at a time when deficits threaten to precipitate an economic crisis, it is understandable that Congress would want to avoid actions that increase short-term pressures on the budget.

Mr. Chairman, in concluding, I would point out that with a normal cost of 20.8 percent of payroll, the pension plan envisioned under S. 1527 achieves only a modest 16.8 percent savings, compared to the current plan. This is still about 2 percent of payroll higher than the better private sector plans. And until federal pension costs get down to the levels provided by the private sector, it is unrealistic to discuss the meaningful kinds of federal pay reform that will be necessary to enable government to compete with private firms for the best talent available.

Finally, I would note that about 72 percent of the savings under this plan would come from the cost-of-living allowance formula, which envisions that COLA's would be two percentage points less than increases in the consumer price index. While such a policy is more or less consistent with private sector practice, it has practical political drawbacks. The public employee unions and retiree associations will fight any such change out of fear that the new COLA formula will next be applied to them. I would recommend, therefore, that the Committee look for savings in other areas, such as reducing the accrual rate under the defined benefit portion of the plan, or raising the federal retirement age to more closely match that under the Social Security program.

Although changes to the bill are in order, it is overall a good effort. Clearly, S. 1527 could do much more to improve the intergenerational fairness of federal retirement policy. But I suspect it is close to the best that can be accomplished this year under existing constraints. For that, the bill's sponsors deserve great credit.

That concludes my comments, Mr. Chairman. Phil Longman and I will be happy to answer any questions the Committee may have.

Senator **Stevens** The next panel is the president of the Federal Managers Association, Mr. Minahan; the general counsel of the Senior Executives Association, Jerry Shaw; and the president of the National Council of Social Security Management Associations, Stephen Bauer.

Mr. Bray and Ms. Ball are accompanying Mr. Minahan, and Mr. Childs and Dr. Strombotne is with Mr. Shaw.

Mr. Minahan, you are first on my list. Why don't you start off.

TESTIMONY OF MICHAEL E. MINAHAN, PRESIDENT, FEDERAL MANAGERS ASSOCIATION, ACCOMPANIED BY BUN B. BRAY, JR., EXECUTIVE DIRECTOR, AND CATHERINE BALL, LEGISLATIVE COUNSEL; G. JERRY SHAW, GENERAL COUNSEL, SENIOR EXECUTIVES ASSOCIATION, ACCOMPANIED BY BLAIR CHILDS, EXECUTIVE DIRECTOR; DR. RICHARD STROMBOTNE, CHAIR, SEA TASK FORCE; AND STEPHEN BAUER, PRESIDENT, NATIONAL COUNCIL, SOCIAL SECURITY MANAGEMENT ASSOCIATIONS, INC.

Mr. **Minahan**. Mr. Chairman, members of the committee, my name is Michael Minahan. I am national president of the Federal Managers Association, full-time career manager working with the Army in upstate New York. I am accompanied by our legislative counsel, Catherine Ball and executive director, Bun Bray.

First, we would like to comment on your efforts and the efforts of your staff in designing a new supplemental retirement system. We recognize the amount of work it entails. We believe the basic design of the plan, a three-tiered system, is sound. We do wish, however, to offer some suggestions for improvement.

We note that upon introducing your bill, as you indicated in the Congressional Record on July 30, you stated, "according to experts, the ideal retirement plan provides benefits that will maintain the standard of living of a career employee into retirement."

Although you indicated that the Stevens-Roth bill provides such a benefit, we must respectfully disagree.

Designing a retirement system is a complex assignment. It is made even more complex here because there will be two different plans in one work force. We must note that our members are adamantly opposed to any changes in the current retirement system.

We are pleased to see that the basic pension is a designed benefit. In addition, we believe that the three-tiered plan provides the best method for moving toward equal benefits for all workers. In a manager's case, he or she has already been penalized in salary growth in the Federal Government. Pay caps and a merit pay system with no pools of money for raises has lessened the value of the Federal manager's pay. To penalize this person further by offering him or her a lower percentage of replacement income at retirement would cause heightened frustrations. The add-on plan appears to do this.

The tilt inherent in Social Security, whereby lower income employees have a larger percentage of their income replaced by Social Security than do higher income employees, is an important item for FMA. While we certainly agree that such a distribution is a noble social goal, most of our members are at the higher end of the salary scale and an equitable solution must be found to offer them a reasonable replacement income. We must point out that what we are designing is a retirement system, not a social welfare program.

In considering the income distribution issue, the two types of plans often mentioned are offset plans and add-on plans. Our membership does not favor an add-on plan, such as in your bill because add-ons follow the tilt of Social Security. Whereas in our current system, workers at all levels of income receive the same percentage of income at retirement, with an add-on our members will receive a smaller percentage of their income than lower income workers.

What FMA would really like is a 100-percent offset plan which would eliminate the tilt. We are willing to compromise on this because it would cost more than the current system. After much soul searching, we are ready to support an offset plan of at least 50 percent, and we strongly urge you to consider this change. This will relocate some of the tilt in Social Security and still enable us to stay within the cost parameters of the current system.

Most of the plans in private industry are 50-percent offset plans.

If we do end up with an add-on plan, some accommodation must be made for higher income employees. Such an accommodation would be a capital accumulation plan.

The CAP as defined in your bill offers a good opportunity for higher grade employees to achieve a reasonable amount of replacement income when they retire, if they have 10 percent of their income to invest. Because the defined benefit part of your plan is an add-on, it is especially important that the CAP offers a chance for significant personal savings. In addition, with the CAP, we believe there is a psychological benefit to depoliticizing at least some of the retirement benefits afforded Federal employees.

We understand that the administration is again proposing the elimination of 401(k)'s. Should this happen, it appears unlikely that your bill will be allowed to retain the CAP's for Federal workers. If the 401(k) is eliminated, we would urge that you reconsider and accept the notion of explicitly integrating this plan so that retirement income is equally distributed to all salary levels.

One of the most important goals in the new system should be to make it as similar to the old system as possible. The ideal would be two people working side by side, one in the current system and one in the new system, with the same benefits. With the inclusion of Social Security into the system, it is not possible to attain such a goal. Even so, we would like to suggest some changes in the features of your plan that will lessen the dissimilarity.

In the current system, employees are eligible to retire at 55 years with 30 years of service with full benefits. Your plan allows retirement at that age with 30 years of service and a 2-percent reduction for every year under age 62. This means a difference of 53 percent of income replaced at retirement in the current system compared with a 23-percent to 38-percent replacement rate in the new system, depending on how much income one has available to put into the CAP. We believe than an employee who gives his or her entire career to the Federal Government is certainly worthy of retiring at 55 with a reasonable expectation of equitable benefits. We believe that it's important to remember that the retirement system is only a part of the total compensation package of the Federal employee. A good retirement system is what has helped us retain top-notch managers. Please keep in mind that the Federal manager has been repeatedly penalized in salary growth.

Federal employees have worked hard to retain a full COLA for annuitants in the current retirement system. We believe full COLA's should continue.

The current system uses the high 3 years of salary in its formula for the defined benefit. Your plan uses the high 5 years. We see no reason for such a change, and in the interests of equity, urge a high-3-year salary base. A 3-year span more closely relates the basic rate to salary.

While we understand the need to contain costs in this atmosphere of concern about Federal expenditures, we submit that the survivor and disability benefits in your plan could benefit by some additional features. For instance, we must insist on a survivor benefit that is payable immediately, regardless of whether the employee was eligible to retire or not.

The introduction of Social Security into the compensation of Federal employment means that some benefit dollars currently spent on retirement benefits will flow to benefit categories not paid under the current system. To reduce the retirement benefit even more by reducing the overall cost of the system would be unfair. We urge you to consider the addition of benefits as we have outlined. It is possible to have a retirement plan that more closely approximates the current one. For the benefit of assuring a continued high quality workforce, it is essential.

On the subject of special category employees, many of our members in FMA are air traffic control supervisors. The changes in the Stevens-Roth bill for these workers are even harsher in their effect than for regular workers. If an air traffic control specialist retires at age 50 with 20 years service under this new bill, as he could under the CSRS, his income replacement rate ranges from approximately 9.4 percent to 14.4 percent with full participation in the CAP. That is, if this worker paid out the 5.7 percent to Social Security and put another 10 percent away in the CAP, he'd get 14.4 percent of his income at retirement.

Senator STEVENS. Let me interrupt you right there. What do you think they do in the private sector? We have people in law enforcement in the private sector. They don't get Social Security until they are 62 and they don't get full retirement until they are 65. Somehow through this whole thread of testimony is a lack of awareness of what the private sector is paying today. You heard the previous witness, I hope. He reflects the sentiment of younger people that the concept of different standards for Federal workers is going to go away. I really think your organization ought to help us find a solution to that problem rather than be critical of the plan that accepts the reality of the marketplace today. If you are in the private sector and you are in law enforcement, you have a special benefit for the 20 years you are in law enforcement, but then you go on to another job. Under the existing situation, if you are in law enforcement in the Federal Government and you get full retirement after 20 years and do not go on to another job, that is what the complaint is. I just don't see that we ought to expect the retirement plan to solve the problem you are discussing.

Mr. MINAHAN. We agree, but we just feel the replacement income based on the current plan for this category of employees is too low. We just feel like it ought to be at a higher rate.

Senator STEVENS. That employee is not disabled at the end of 20 years. He or she is going on to another job. It is like military person retiring after 20 years. They go on to other jobs. They don't get full retirement at the end of 20 years. What you are telling me is we ought to have full retirement at the end of 20 years.

Mr. MINAHAN. We certainly ought to have it at a higher level than 14.4 percent or replacement income. We would be delighted to work with the committee on this. We just feel it is too low. We will work with you on trying to make it a bit more equitable for this special category. Air traffic control is a very difficult job. I think we have to recognize that, witness the last several years in the system. We have managers that are working extraordinarily long hours and they are burning out. Just the normal job.

Senator STEVENS. I certainly agree. While they are doing that extrahazardous duty, they ought to get extra pay and they ought to be fully compensated for it but we ought not to expect the retirement plan to compensate for that fact because they are going on to another job when they are 50. And you are really asking us to give them full retirement at 50, notwithstanding the fact that they are going on to another job. That is the complaint that is coming from the private sector.

Mr. MINAHAN. What we don't want is to have them treated differently than those under the current system.

Senator STEVENS. It's the current system we cannot continue. That decision was made by Congress. The Federal employees were not under Social Security before the decision by Congress. Now they are not eligible for Social Security until they are 62. There is nothing special in Social Security for people who hold law enforcement or other high-risk jobs. That is the difficulty that we face. I agree with you but I think your group above all ought to help us find a solution for the problem of the person who is burned out as far as the job he or she is in now and find a solution of what we do with those people in the Federal system if they want to continue to work and now to compensate them for the 20 years at the higher wage they deserve. That is the real thing. If they had the proper compensation for the 20 years, we wouldn't have the retirement problem. That is what the young man who preceded you is really saying.

Mr. MINAHAN. Our organization is committed to work with you and your committee on this subject.

Senator STEVENS. Thank you very much. Sorry for the interruption.

Mr. MINAHAN. While it is true we are asking for several things, we are also willing to concede that some costs will have to be incurred by the emoloyee. We believe that by requiring level contributions, that is, that each employee contributes 7 percent of pay minus the amount paid to Social Security, Federal employees will be able to have a satisfactory retirement plan. By adding up the changes incurred by our suggestions we can keep the thrift savings plan as it is—an even more important point if we stay with an add-on plan—and end up with a cost of approximately 25 percent, similar to the cost of the current system.

In conclusion, we must seek to provide the work force with an adequate. stable income to maintain each person's standard of living. As we have said, a retirement plan is a form of deferred compensation. It is not a social welfare program. It aids in attracting and retaining a competent work force. We have taken significant cuts in benefits over these last few years. An attractive retirement plan is about all we have left to entice people to come into Government service. I would be happy to relate some of the experiences we, as managers, have had in attracting and retaining workers.

Finally, the current system offers some features that have proven to be important and valuable to the work force. These features, such as retirement at age 55 with 30 years service and unreduced benefits, calculating the benefit on the high 3 years of salary, and full cost-of-living adjustments, have been seen as steps forward in the design of retirement plans.

Let's not move backward by eliminating these features in the new plan. Much has been said about the high cost of our current retirement system. We seem to have lost sight of the fact that many of the retirement plans of the larger companies in this country are more generous than the civil service retirement system. We must ask ourselves whether we are seeking mediocrity or excellence in a retirement plan for Federal workers.

That completes our testimony. We will be happy to answer any questions you may have.

Senator STEVENS. Thank you very much.

Mr. Shaw.

Mr. SHAW. Thank you very much. We thank you for the opportunity to testify on S. 1527 to establish a new retirment system for new Federal employees who are now covered by Social Security. I am G. Jerry Shaw, general counsel of the Senior Executives Association and I am accompanied by Mr. Blair Childs, executive director, and Dr. Richard Strombotne, chair of the SEA task force on retirement issues.

As you know, Mr. Chairman, SEA is the professional association representing the interests of career Federal executives who are responsible for directing all the programs and operations of the Federal Government under the policy guidance of political leadership and the statutory requirements enacted by Congress.

We are vitally interested in the retirement system for new employees for several reasons. We have spent more time on this piece of vital legislation than any other in our history. Why? Because first, Mr. Chairman, it is our job as career executives to make sure that the Government that we operate attracts and retains high quality employees whom we manage.

Second, we believe it is important for the Government that the new system be sufficient to insure continuity of Federal operations, as well as insure that citizens of this country are willing to make a career commitment to public service. Third, the new retirement system will directly affect future senior executives and possibly current executives and employees who decide to transfer to the new system and, therefore, will affect the ability of the Government to attract and retain topnotch career managers and executives.

The SES was established by the Civil Service Reform Act in order to provide a cadre of career executives who were professionals in their occupation, who would provide continuity in Government operations, and who were available to be placed by their agency in positions which the political leadership deemed important. Members of the SES gave up most of their job protections, which many other Government employees continue to enjoy in order to be judged on their performance and to be rewarded or removed from the SES on the basis of their continued performance.

When the SES was established, over 95 percent of the career executives in Government voluntarily entered the system. They did so because they believed there were greater challenges, and they were willing to compete to stay in the SES on the basis of their performance. A bonus and award system was set up to reward these outstanding individuals who excelled at their profession, but the implementation of such a system has been very slow.

A retirement system is an extremely important part of the compensation package which the Government must rely on to attract career executives into the SES and to retain them there for the remaining years of their career. Every study made of compensation between career SES members and the private sector shows that they are woefully underpaid for the amount of responsibility they carry and the importance of their duties in comparison to private sector executives at similar levels.

In fact, over 50 percent of the career SES members who voluntarily entered the SES in 1978 have since resigned or retired from the Senior Executive Service. Those who have remained, and those who have newly entered the SES, have done so in large part because of the retirement system currently in place. A new retirement system which does not have the attrac- tiveness of the current retirement system could be a major disincentive to attracting quality people to the ranks of the career executives. It is imperative that the new system that is in place be sufficient to attract and retain executives who can carry out the complex missions of the Federal Government. We think the outlines of such a system are contained in this legislation, but we emphasize at the outset that without the capital accumulation plan that is contained in this bill, it would not meet the goal of attracting good people.

Before commenting on the specifics of this bill, I want to express our appreciation to Senators Stevens and Roth for their leadership and efforts over the past years to deal with the very complicated issue associated with the design of a new retirement system which is fair to employees and which is seen to be fair by all involved.

We strongly support the philosophy that the new retirement system should follow the best private sector practice in most respects, with a few exceptions appropriate for a staff retirement system of the Nation's largest employer. The GAO report of June 1984 on features of private sector retirement systems is an excellent source of information and evaluation. It is important to note that the Federal Government, as an employer of predominately professional, technical, and administrative personnel, is generally competing with the largest companies and organization in the country for talent, not with the smallest.

We support the overall design of the new retirement system so long as it includes all of the three principal components. It is imperative that Social Security coverage be supplemented by a noncontributory defined benefit plan, and a voluntary tax deferred thrift plan with 1 to 1 employer matching of an employee's contributions up to a minimum of 5 percent.

The new retirement system should permit the employee who has devoted a full career of 30 years to public service, and his spouse, to maintain the same standard of living after retirement as they had before retirement. As you know, benefits under Social Security are tilted toward the employee with lower lifetime earnings. That is, the percentage of final pay replaced by annuities under Social Security is much greater for lower paid employees than it is for higher paid employees. By contrast, the current CSRS provides annuities that replace the same percentage of final average pay for both higher paid and lower paid employees having the same age and length of service.

As proposed, the defined benefit plan portion is simply added on to the benefits of Social Security. There would be a very large disparity in retirement income at age 62 for the 30-year career high-income employee under this proposal without the capital accumulation plan [CAP]. For example, the employee with $60,000 final salary would receive 10 percent of final pay from Social Security while the employee with $30,000 final salary would receive 18 percent of final salary. Even with the defined benefit portion of the plan added to Social Security, the higher paid career employee would receive only 37 percent of final pay in pension if the CAP was not in place. Attached to our testimony is a chart by the Congressional Research Service setting forth relative disparities between the lower paid employee and the higher paid employee utilizing Social Security and the defined benefit plan.

Approximately 90 percent of private firms utilize what is known as an offset plan to eliminate part of the Social Security tilt. They integrate the defined benefit component with Social Security so that replacement rates for lower and higher compensated employees are not at disparity. The current bill does not employ an offset to compensate for the Social Security tilt, but instead establishes the CAP to do so. It is absolutely imperative that the CAP proposed in this legislation remain strong or the Government will be at a serious disadvantage in competing for higher paid executive, managerial, professional, and technical talent.

I would like to digress for a moment, Mr. Chairman, at this point and respond to a question Senator Eagleton asked of the prior panel. The issue was whether 1.3 percent would be placed in the defined benefit portion of the plan or would the employees prefer that it be contributed to a capital accumulation plan, or which would the organizations testifying prefer. The organizations said they would obviously prefer the higher return that would come from the capital accumulation plan if the return was guaranteed.

In fact, as you know, Mr. Chairman, a 7.5-percent return is guaranteed by the Government bonds which the capital accumulation plan would be placed in and that 1.3 percent, as Senator Eagleton pointed out, the Congressional Research Service said, would return the 12 percent on the investment guaranteed. I think that is an important point and I was urged by some Congressional Research Service representatives in the audience to make that point.

The capital accumulation plan is so important and that is particularly true when one considers that the recent Hay study reports that Federal employees lag behind their private sector counterparts by about 10 percent in overall compensation.

This disparity is even more severe for executives where it has been found that total cash compensation would have to be increased 58.4 percent to equal aggregate private sector total cash compensation. We cannot endorse strongly enough the CAP plan as the only acceptable alternative to not using an offset to the Social Security tilt.

SEA strongly opposes the CPI minus 2 COLA adjustment for the defined benefit plan portion of the proposed retirement system. We feel that a full COLA is necessary as an essential part of the compensation system. For a career executive, a substantial amount of his/her retirement income under the proposed bill would, of necessity, come from investment in the CAP. Since Social Security would make up a very small portion of the replacement rate, the COLA on Social Security would be a very small protection for higher paid executives. Since there would be no cost-of-living protection on the CAP and if there was a reduced COLA on the defined benefit portion, executives, as well as Members of Congress, would have little protection against substantial erosion of their retirement benefits over a normal retirement span.

The reduced COLA on the defined benefit would have a much bigger impact on higher paid employees than lower paid employees.

Senator STEVENS. Do that again.

Mr. SHAW. Assuming Social Security continued at full COLA and there was a COLA minus 2 or 1, whatever, on the defined benefit portion and no COLA protection——

Senator STEVENS [interposing]. It is 100-percent COLA on the top; By definition it is adjusted for inflation since the account continues to draw investment from the private sector.

Mr. SHAW. 100 percent COLA on the capital accumulation plan?

Senator STEVENS. Right. It is in the private sector, therefore, it is adjusted by the private sector to inflation.

Mr. SHAW. Except, Mr. Chairman, the retired employee would be drawing down the amount that that pot of money would be able to draw from the private sector.

Senator STEVENS. No; it is equal to the private sector, therefore, it is equal to the CPI. By definition it is going to keep up—the figures were given to us yesterday—it would keep up over the 20-year period. Any 20-year period would show it was equal to or ahead of inflation.

Mr. SHAW. The capital accumulation plan.

Senator STEVENS. If it is invested in the private sector.

Mr. SHAW. We would like to see the figures, Mr. Chairman. We are not aware of those. That might well change our position.

Senator STEVENS. That is why it is out there in the private sector. It is automatically involved in the spirals that take place in the private sector, which are what brings about the adjustments in COLA. If you put it in Government bonds, they are not necessarily indexable to the private market. By definition, some of that fund is going to be in stocks and bonds which appreciate rather than just earn interest according to the fluctuation of the interest rates.

Mr. **Shaw**. As I understand, the employee would determine what portion was in——

Senator **Stevens** [interposing]. They would have the option in some broad categories to decide what level of risk they want to incur. I think we ought to look at that.

Senator **Gore**. I think Dr. Strombotne wanted to make a comment on that.

Mr. **Strombotne**. Yes, if I may. In discussions with your staff, Senator Stevens, Mr. Cowens had explained that the tables prepared by the Congressional Research Service analyzing the cost of the Stevens-Roth bill make an assumption that the capital accumulation, the annuity purchased by the capital accumulation plan, would increase at some constant rate appropriate to the economic assumptions. I believe that is correct. And that is appropriate, of course, for considering the overall costs. Looking at it from the standpoint of an individual employee or retiree, he sees a certain amount of money invested in a capital accumulation plan and there is no guarantee that his fund will share in future inflation and, generally, inflation is pretty bad for any kind of fixed investment. Stocks don't do too well under those conditions.

I believe the point Mr. Shaw was making is there was no guarantee of a full cost-of-living adjustment on the capital accumulation plan. That is the point we wanted to make.

Senator **Stevens**. There is no guarantee of COLA's, as we have witnessed. There is a greater quarantee in the private marketplace than there is congressional acquiescence in the COLA's year after year after year. We want to put that fund out in the private sector. As we said yesterday, we hope to liberalize it as we go along: a portion of it in real estate, a portion of it in bonds, a portion of it in Government bonds, a portion of it in Government notes. In effect, if an employee were participating in a diversified portfolio as he would have the option to do, he would have the best protection against inflation, better than relying upon the Governemnt, better than relying upon Congress. I can show you, the history is that Congress has never responded in 20 years either.

If you want to look at the inflationary spiral, the best protection is the person who has his money in a diversified portfolio in the private sector. The next best protection is the person who has some guarantee from the Federal Government, but that is always 4 or 5 points below what has been the return in the private sector. I just saw published the other day some of the funds of the, what do they call them, the mutual groups, particuarly one out of Boston. They were substantially ahead of anyone who had money in Government bonds. Over the past years, your money has been and mine too, at what, 4, 5½ percent. During this period of 13- to 20-percent interest, we were getting 4 and 5 percent. Now we are getting about 11. But when the interest factor goes up to 22, we will still be getting 11. I would hope your people above all would recognize the advantage of the third tier. I think you do, Jerry.

Mr. **Shaw**. We don't disagree with that point, Mr. Chairman. We really would like to see the figures. I think we can be persuaded. Our fear is from a guarantee standpoint, assuming a Social Security COLA remains and there is a minus on the final benefit, the lower paid employee would have a much better guarantee against inflation than higher paid. We would certainly like to go over that.

Senator **Stevens**. I think you ought to go over it. If you assume 5 percent of salary, as I pointed out yesterday, through the contribution pattern here, we are already providing 1.3 percent of that to start with—1.7, really, when you consider the free insurance. It is 1.7 percent of the first 5 percent that is provided in this bill. If you put in the extra 3.3 to have 5 percent, that 10 percent over a period of time has a staggering value if it is properly invested.

Mr. **Shaw**. It does, Mr. Chairman. That raises another response on Senator Eagleton's question to the postal unions. One of the things is, putting the money in the thrift plan would be better than the defined benefit plan for employees who do not stay for a full career. There is portability in the thrift plan. That money can be rolled over and continue to earn their benefit if the 1.2 was put into the defined benefit plan. Of course, the short-term employee would not benefit.

Senator **Stevens**. I want to let you finish. In going over last night what I hear in terms of having the contribution increase—and we are looking at, say, 7.5, 8 percent of the first 2 years and then make it 1.15 for the next 10, and graduate after that—I should think what we ought to do is also makethe matchable concept increase with the years as far as the thrift plan is concerned because as I look back, I had more money to save in the last 10 years than I did in the first 20. We ought not to presume everybody is able to save money in the first 10, 15 years of employment. We want to look at that and see if we can't, in terms of the employee's career, give a higher degree of match at the time when he or she has more money to invest. Again, you could help us on that.

Mr. **Shaw**. We will be very pleased to work with you on that. I think one of the things, since new employees coming into the system right now are obviously lower grade employees, people are concerned about that. The normal career progression is going to bring those employees coming into Government now in another 10, 15 years up into the middle-, senior-level groups, and I think that kind of provision would be helfpul to all employees.

The provision, Mr. Chairman for optional, normal retirement at age 55, or greater, for an employee with 10 or more years of service, but less than 30 years of service, with a penalty of 5 percent per year for each year before age 62, is commendable. It would provide employees with a wider range of choices, at no cost to the Government, and we support it.

We recognize that the penalty of 2 percent per year for each year before age 62 that would apply to normal retirement—or involuntary retirement—conforms with typical private-sector practice. Nevertheless, the GAO and other studies point out that some large firms permit retirement at age 55 with no penalty. In order to encourage long-service employees who dedicate their professional lives to the Government, we think that an employee who has served his country for 30 years should not be penalized for deciding to retire at age 55 with 30 years of service. What is more, the cost of unreduced retirement at age 55 and 30 years of service is relatively small, and we are not talking about Social Security offset here. It would be 1½ percent of payroll.

Senator STEVENS. Do you know why that is, Jerry? The answer is no one will take it without Social Security at 62. I couldn't figure out why they were telling us it was one-half of 1 percent. The reason is, who is going to do it?

Mr. SHAW. The principle, however, the 55 years, 30 years without reduced, I think, is an important principle and most employees probably won't retire; many now do not retire at 55 when they are eligible. However, the fact they have that is an important principle to them and one we very, very strongly support. If they choose to stay, assuming the Government is a competitive employer, and they choose to stay for those extra 7 or 10 years, then that is an option the employee should be able to make. That is a principle we support.

Senator STEVENS. I will agree with you if you help me work out the reemployeed annuitant problem of people who decide they are going to get out but stay in. That is one of the things going on right now, and I think under this new system we complicate it if we face that. The option ought to be get out. If you are going to stay working with Uncle Sam, you stay in rather than get out and still come back in. That is the worst part about this system when you have that thrift plan out there, to have someone out and getting the pension plan but still in and getting the kicker.

Now that won't work. You show us how we can keep your commitment for 55 and 30 and we will agree to it as long as there is an option to get out, but you can't be employed by the Federal Government if you are out, and I mean anywhere.

Mr. SHAW. Mr. Chairman, we will certainly look at that and we will discuss that with your staff. I think we can be—for myself personally, I think we can support that.

Senator STEVENS. Everyone is for 55 and 30.

Senator GORE. I think in terms of the political support for what we enact here, that is something that is going to have to be addressed. I will look forward to joining in those discussions.

Mr. SHAW. We are not going to speak to the survivors annuity provisions, which I think everyone recognizes are inadequate, because we understand you stated earlier today that you are dealing with those.

We do, however, believe the provision of the current civil service retirement system for joint and 50-percent survivor annuity at a cost of 2½ percent reduction in the first $3,600 of annual annuity payments and 10 percent of annual payments above $3600 should be retained in the new system and used as the basis for any further actuarial adjustment needed for other options. We believe it is a reasonable balance between the individual employee having to completely fund the survivor annuity and the employee having to fund none of it.

We strongly support the 1-to-1 matching ratio for contributions to the tax deferred CAP which will provide a strong incentive for a high percentage of all new employees to participate. The 5-percent limit provides these employees with an opportunity to save for additional retirement benefits as they see their own needs. It is particularly important that the higher paid half of the employees have access to such a plan to compensate for the Social Security tilt. We advocate permitting a higher percentage of salary be invested in the CAP than the proposed 10 percent.

Virtually all employee groups in the country potentially have access to some kind of tax-deferred retirement saving plan whether it is 403(b), 401(k), 457, et cetera. Indeed, even nonprofit organizations can proovide a 401(k) or in some instances a 403(b) profit sharing plan for their employees, as the April 29, 1985, issue of Forbes points out.

Federal employees are virtually the only major group of employees that have not been included as yet. We recommend that all Federal civilian and military employees be provided with the opportunity to contribute to a tax-deferred CAP, not limited to the new employees, and that the contribution limit be set at 20 percent of statutory pay. This change would remove an oversight that has become a gross inequity. We are not recommending any employer matching of an employee's contributions, except in the new retirement system.

In consideration of how the new retirement system is to be administered, it is apparent that the defined benefit component can be viewed as a variation on the current CSRS and that OPM is the appropriate agency to administer it. The New Capital Accumulation Program is, or should be, a different matter. We recommend that a separate, independent organization be formed to administer the CAP for the benefit of its participants, that is, current, and past employees, and annuitants.

In addition, careful attention needs to be given to the appointment authorities and to organizational matters to ensure that the administration is performed objectively, fairly, and without partisan bias.

Mr. Chairman, we have a very long list of technical provisions which we would like to submit that would deal with some of the points on how the capital accumulation plan should be administered. This concludes our prepared testimony. We want to thank you, Senator Roth and others, again, for giving us this opportunity. We will work with your staff and we fully support this bill so long as we have all three components of the system in place in your proposed retirement plan.

Thank you, Mr. Chairman.

Senator STEVENS. Mr. Bauer.

Mr. BAUER. Mr. Chairman, we thank you for the opportunity to testify on S. 1527. I speak for an association that is comprised of Social Security field office managers and supervisors. My name is Stephen Bauer. I am president of that association.

Let me note that we lack the expertise to examine the accuarial projections of the proposed legislation and, therefore, I will only make comments concerning certain principles that the bill establishes for the new retirement system.

The bill would provide a high replacement rate for lower grade employees who retire at age 62 with 30 years of service. If the employee was to participate fully in the thrift program portion of the bill, the replacement rate at retirement age of 62 with 30 years of service for a $20,000 per year employee would be approximately 69 percent. For a higher paid employee whose average salary was approximately $48,000, the replacement rate, again, if fully participatinq in the thrift program, would be approximately 55 percent.

The replacement rate, of course, would vary depending upon the amount of participation in the thrift program, but the projected rate of salary would still be substantially in excess of 50 percent for lower grade employees and could be substantially less than 50 percent for higher grade employees. This further will increase the problem that we face of retention in the management ranks where the comparability pay-gap increases with grade.

Managers would end up suffering disproportionately in compensation both while they are working and subsequently in retirement.

We do not object to the higher replacement rate for lower grade employees. We just believe the salary replacement level should be the same for all employees at all grade levels. This could be achieved under the defined benefit portion of the plan by providing employees at higher grade levels, for example, GS-11 or above, with additional contributions from the employer. It could also be accomplished by providing for higher matching contributions from the Government for contributions made to the thrift program by higher grade employees. Lacking, again, the expertise to propose a solution to this dilemma that we see, we suggest that the Congressional Research Service make calculations and evaluate the cost of providing the same replacement rates for higher grade employees as those that will be received by lower grade employees. This is imperative in order to retain senior managers and executives in Government.

Our main concern as Federal managers is that recruitment and retention problems will increase and we will be unable to effectively perform the functions entrusted to the Federal Government.

If Congress decides to equalize replacement rates, we have heard testimony today of different offset plans for Social Security that can be used to correct the tilt in Social Security benefits. We can note that we would strongly recommend any offset plan only taking into consideration Social Security benefits earned during Federal service. For short-term Federal employees, if we off-set Social Security earned in other employment against the defined benefit plan annuities, that would be unfair and could reduce their annuity to virtually nothing.

We strongly recommend that retirement be made available without reduction at age 55 with 30 years of service. We recognize that the average Federal employee works until nearly age 60, which is very similar to the private sector. However, few employees, either in Government or out of Government, spend 30 years with a single employer. Those who do should be rewarded for their continuous and dedicated service to the Government and should be granted an annuity at age 55 without actuarial reduction. Indeed, more and more private plans are providing such a benefit.

At present, Federal employee pay levels are not competitive, health insurance coverage is lower, and other fringe benefits are being proposed for reduction. One of our grave concerns is that this situation, coupled with a retirement system which does not reward an employee for length of service, will induce a dramatic rate of turnover in the ranks of midlevel management. There has to be an incentive, and a strong incentive, for a Federal employee to choose public service as a career and to stay with that career during his working years. If Congress decides to treat Federal employment as just another career, then all pay benefits should be competitive with the private sector in order to retain quality managers at the middle and senior grade levels.

I think we need to note this will probably be a strong inducement and would encourage people to participate fully in the thrift program so they potentially, for example, could retire at age 59½, roll over to an IRA, and reduce that difference in the time between 59½ and or 62 with contributions of withdrawals from their IRA Program.

Senator STEVENS. I was looking at that. You are right. It is a very good program.

Mr. BAUER. We think retirement at 55 with 30 years of service would be an important aspect to retain. That would be one of the reasons.

We are adamantly opposed to the COLA minus 2 or any other COLA reduction provision. That has been discussed here at great length today. But as Social Security managers, we have seen in the past the result of lack of cost-of-living increases in benefits prior to Congress in its wisdom enacting COLA protection on a regular basis, and we saw that decision confirmed in Congress this past year.

An individual retiring at age 55 or age 60 could see a dramatic decrease in purchasing power within 15 years after retirement in his defined benefit with a COLA-minus-2 option. It is in the annuitant's later years that it is much harder to replace that benefit lost to inflation by going to work because they are much more likely at that point to be too sick or too elderly to obtain other employment.

In the long run, I think it would not be a wise decision to place Government annuitants in that position.

Finally, and it has been mentioned several times, the survivor and disability provisions of S. 1527 are extremely important. A young worker with children has unconscionably inadequate protection. At Social Security, we preach the Social Security benefit is intended only as a floor of protection. S. 1527 does very little to provide the walls and the roof for a family's protection. I was pleased, Mr. Chairman, to hear you will be addressing that important problem and we view that as an essential issue in an adequate retirement system for Federal employees.

Overall, with those modifications, we could support the proposed legislation; We would very much appreciate the opportunity to work with you, Mr. Chairman, and the members of your committee and staff in order to achieve passage of this legislation.

Thank you again for the opportunity to testify. Again, we do appreciate how difficult it is to come to grips with the various issues involved in this program, and we will be happy to answer any questions you have.

Senator STEVENS. I don't have any questions. I have injected mine as we went along. The full COLA concept, obviously, is the most difficult to achieve and maintain the thrift plan at the same time. The cost of the full COLA is such that it would totally eliminate the thrift plan if we are going to stay within the budget directives. So it is a difficult proposition. It is 3 percent of payroll to restore the COLA. But if you put that same amount into the thrift plan, it has an elasticity that is not there with just the COLA.

Again I would urge you to study it. If restoring the full COLA is an absolute necessity, we have to abandon the third tier, except just for voluntary contributions with no matching. I personally think the thrift plan has more to offer in terms of long-term security for a new employee. I would appreciate your comparison. If you have any further comments you would like to submit on that, I will be happy to have them.

Senator Gore.

Senator **Gore**. You are all in favor of the thrift plan, is that correct?

Mr. **Shaw**. Absolutely. We do not think the retirement system is viable at all for midlevel managers and senior level managers without the thrift plan.

Senator **Gore**. All three of you are in favor of it?

Mr. **Minahan**. That is correct.

Mr. **Bauer**. Yes.

Senator **Gore**. All three of you are in favor of a full COLA?

Mr. **Minahan**. Yes, sir.

Mr. **Bauer**. That is correct.

Senator **Gore**. All three of you are in favor of retirement at age 55 without penalty?

Mr. **Minahan**. That is correct.

Mr. **Shaw**. That is correct, but we understand it would be—since Social Security would not be present, the incentive to retire at age 55 would not be as high.

Senator **Gore**. If you are all three in favor of all three of those things, then is it fair to conclude that all three of you are in favor of a new plan that costs significantly more than the present plan?

Mr. **Shaw**. We wouldn't oppose—— [Laughter.]

Senator **Gore**. Pardon me?

Mr. **Shaw**. We would not oppose a little more contribution by the Government to this plan. They sure saved enough on our pay in the last 5 years or so.

Senator **Gore**. Mr. Minahan.

Mr. **Minahan**. We want it to be similar in cost to the current system.

Senator **Gore**. Maybe a little more?

Mr. **Minahan**. We are not asking for more.

Senator **Gore**. How can you not have more if you have what you have now plus the capital accumulation plan?

Mr. **Minahan**. We are suggesting level contributions at 7 percent.

Senator **Gore**. Mr. Bauer.

Mr. **Bauer**. I believe that we need to look again at the picture we miss sometimes, that is, the overall compensation.

Senator **Gore**. I don't disagree with you there. As long as we are looking at overall pictures, do any of you believe that a plan more expensive than the current one would both pass the Congress and be signed by the President this year?

Mr. SHAW. No.

Senator GORE. Where do you come out then?

Mr. SHAW. I think the assumptions, Senator—and I know you have worked on this and probably know it better than we do—the assumption if you had 55 and 30 retirement eligibility, if you don't have a social security base, No. 1, as Senator Stevens pointed out, as the Congressional Research Service points out, that costs 1½ percent of payroll. That is not really an expensive item.

The Senior Executive Associations is willinq to look at the figures Senator Stevens provided this morning on the fact there is COLA protection on the capital accumulation plan. That would obviously cause us to rethink our position. But it is very difficult for us as representatives of an organization to say we are not for COLA protection. We have seen what that has done to others in the past.

Senator GORE. Are you, Mr. Shaw, and you, Mr. Bauer, both in favor of level contributions as Mr. Minahan is?

Mr. SHAW. No; we like the contribution the way it is set up in the current plan.

Senator GORE. Mr. Bauer.

Mr. BAUER. We have a problem with the current plan——

Senator GORE [interposing]. Are you in favor of level contributions?

Mr. BAUER. Yes.

Senator GORE. I have some additional questions which I will submit in writing to you because of the time constraints we are under. Did you want to add something else?

Mr. MINAHAN. Considering the recommendations FMA has made in approving the Stevens-Roth bill and taking into consideration level contributions at 7 percent, our calculated cost is 24.4 percent of payroll, 3/10 percent under—using the figures from the Congressional Research Service information.

Senator GORE. If we did have level contributions, would you object to a requirement that such contributions be made to the thrift plan rather than to the defined benefit plan?

Mr. MINAHAN. We would prefer that they be to the defined benefit plan.

Mr. SHAW. Senator, we prefer they be made to the thrift plan for two reasons. One, for shorter-term employees who don't stay for full career, they are portable, and second, because the return would be better on the 1.3 percent in the thrift plan than it would be defined benefit plan. I am glad Senator Eagleton walked back in because it pertains directly to the question he asked the Postal Service or Postal Service representatives on the 1.3 and defined benefit or the thrift. In fact, Senator, the Congressional Research Service member here in the audience informed me that if the 1.3 went into the thrift plan and the 12-percent return is based on a 7½ percent return on Government bonds which are by law guaranteed, a 12-percent return on the 1.3 in the thrift plan is guaranteed versus if the 1.3 percent in the defined benefit plan.

Senator GORE. I, in fact, asked that question in behalf of Senator Eagleton and he may wish to pursue it. But let me say I appreciate your testimony. We certainly appreciate your appearance here today.

Mr. **Shaw**. Senator Gore, on behalf of the Senior Executives Association, we know you have put a tremendous amount of time, effort, and study into this and we really do appreciate it very much.

Senator **Gore**. I appreciate that. The work began long before I became a member of this committee.

Mr. **Shaw**. But you have caught up.

Senator **Gore** [presiding]. Thank you all.

[The prepared statements of Messrs. Minahan, Shaw, and Bauer follow:]

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TESTIMONY OF MICHAEL E. MINAHAN, PRESIDENT
FEDERAL MANAGERS ASSOCIATION
BEFORE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
SEPTEMBER 10, 1985

First, we would like to commend your efforts and the efforts of your staff in designing a new, supplemental retirement system. We recognize the amount of work it entails. We believe that the basic design of the plan, a three-tiered system, is sound. We do wish to offer some suggestions for improvement, however.

We note that upon introducing your bill into the Congressional Record on July 30, you stated, "According to experts, the ideal retirement plan provides benefits that will maintain the standard of living of a career employee into retirement." Although you indicated that the Stevens-Roth bill provides such a benefit, we must respectfully disagree.

Designing a retirement system is a complex assignment. It is made even more complex here because there will be two different plans in one workforce. We would note here that our members are adamantly opposed to any changes in the current retirement system.

We are pleased to see that the basic pension is a defined benefit. In addition, we believe that the three-tiered plan provides the best method for moving toward equal benefits for all workers. In a manager's case, he or she has already been penalized in salary growth in the Federal government. Pay caps and a merit pay system with no pools of money for raises has lessened the value of the Federal manager's pay. To penalize this person further by offering him or her a lower percentage of replacement income at retirement would cause heightened frustrations. The add-on plan appears to do this.

I. PLAN DESIGN

Social Security "Tilt"

The tilt inherent in Social Security, whereby lower-income employees have a larger percentage of their income replaced by Social Security than do higher-income employees, is an important item for FMA. While we certainly agree that such a distribution is a noble social goal, most of our members are at the higher end of the salary scale and an equitable solution must be found to offer them a reasonable replacement income. We must point out that what we are designing is a retirement system, not a social welfare program.

In considering the income distribution issue, the two types of plans often mentioned are offset plans and add-on plans. Our membership does not favor an add-on plan, such as in your bill, because add-ons follow the tilt of Social Security. Whereas in our current system, workers at all levels of income receive the same percentage of income at retirement, with an add-on our members will receive a smaller percentage of their income than lower-income workers.

What FMA would really like is a 100% offset plan which would eliminate the tilt. Unfortunately, there are major problems with such a plan, one of which is that it would be illegal in the private sector. Another is that it would cost more than the current system. After much soul-searching, we are ready to support an offset plan of at least 50% and urge you to consider this change.

This will relieve some of the tilt in Social Security and still enable us to stay within the cost parameters of the current system. Most of the plans in private industry are 50% offset plans.

If we do end up with an add-on plan, some accommodation must be made for higher-income employees. Such an accommodation would be a capital accumulation plan.

Capital Accumulation Plan (CAP)

The CAP as defined in your bill offers a good opportunity for higher grade employees to achieve a reasonable amount of replacement income when they retire, if they have 10% of their income to invest. Because the defined benefit part of your plan is an add-on, it is especially important that the CAP offers a chance for significant personal savings. The options available under the plan for investment and disbursement of the funds allow Federal employees greater discretion in planning their retirement. In addition, we believe there is a psychological benefit to depoliticizing at least some of the retirement benefits afforded Federal employees.

We understand that the Administration is again proposing the elimination of 401(k)s. Should this happen, it appears unlikely that your bill will be allowed to retain the CAPs for Federal workers. If the 401(k) is eliminated, we would urge that you reconsider and accept the notion of explicitly integrating this plan so that retirement income is equally distributed to all salary levels.

II. FEATURES OF THE PLAN

One of the most important goals in the new system should be to make it as similar to the old system as possible. The ideal would be two people working side by side, one in the current system and one in the new system, with the same benefits. With the inclusion of Social Security into the system, it is not possible to attain such a goal. Even so, we would like to suggest some changes in the features of your plan that will lessen the dissimilarity.

- Age - In the current system, employees are eligible to retire at 55 years with 30 years of service with full benefits. Your plan allows retirement at that age with 30 years of service and a 2% reduction for every year under age 62. This means a difference of 53% of income replaced at retirement in the current system compared with a 23%-38% replacement rate in the new system, depending on how much income one has available to put into the CAP. We believe that an employee who gives his or her entire career to the Federal Government is certainly worthy of retiring at 55 with a reasonable expectation of equitable benefits. We believe that it's important to remember that the retirement system is only a part of the total compensation package of the Federal employee. A good retirement system is what has helped us retain top-notch managers. Please keep in mind that the Federal manager has been repeatedly penalized in salary growth.

- Cost-of-living adjustment - Federal employees have worked hard to retain a full COLA for annuitants in the current retirement system. We have fought hard because it is untenable to allow a retiree's income to shrink each year at a time in one's life when market forces have the most impact.

- Salary base - The current system uses the high three years of salary in its formula for the defined benefit. Your plan uses the high five years. We see no reason for such a change, and in the interests of equity, urge a high three year salary base. Further, because the accrual rate (1%) is so much lower than in the current system, it is important that the salary base be as accurate a reflection of salary as possible. A three-year span more closely relates the basic rate to salary.

- Survivor and disability benefits - While we understand the need to contain costs in this atmosphere of concern about Federal expenditures, we submit that the survivor and disability benefits in your plan could benefit by some additional features. For instance, we must insist on a survivor benefit that is payable immediately, regardless of whether the employee was eligible to retire or not. In addition, actuarially reducing the survivor's benefit to the extent that your plan does, is about the same as offering no benefit at all.

- Cost - The introduction of Social Security into the compensation of Federal employment means that some benefit dollars currently spent on retirement benefits will flow to benefit categories not paid under the current system. To reduce the retirement benefit even more by reducing the overall cost of the system would be unfair. We urge you to consider the addition of benefits as we have outlined. It is possible to have a retirement plan that more closely approximates the current one. For the benefit of assuring a continued high quality workforce, it is essential.

- Special categories of employees - Many of our members are air traffic control supervisors. The changes in the Stevens-Roth bill for these workers are even harsher in their effect than for regular workers. If an air traffic control specialist retires at age 50 with 20 years service under this new bill (as he could under the CSRS), his income replacement rate ranges from approximately 9.4% to 14.4% with full participation in the CAP. That is, if this worker paid out the 5.7% to Social Security and put another 10% away in the CAP, he'd get 14.4% of his income at retirement. The way this bill is set up, a controller would do far better leaving on disability than retiring. This would put a tremendous stress on the disability system. These employees have been put in a special category because we have found over the years that they need to retire earlier with fewer years of employment. It is in our best interest that they do so. The arbitrary changes you seek disregard what we have learned thus far.

There are some points regarding special category employees that do not appear to be addressed in the bill: a mandatory retirement age, and the ability to retire with 25 years of service at any age with a guaranteed annuity. We would hope that these points will be dealt with before the bill is released from committee.

While it is true that we are asking for several things, we are also willing to concede that some costs will have to be incurred by the employee. We believe that by requiring level contributions, that is, that each employee contributes 7% of pay minus the amount paid to Social Security, Federal employees will be able to have a satisfactory retirement plan. By adding up the changes incurred by our suggestions - 55/no reductions, full COLA, high-three salary base, changes in survivor and disability benefits, and the addition of level contributions - we can keep the thrift savings plan as it is (an even more important point if we stay with an add-on plan) and end up with a cost of approximately 25%, similar to the cost of the current system.

In conclusion, we must seek to provide the workforce with an adequate, stable income to maintain each person's standard of living. As we have said, a retirement plan is a form of deferred compensation. It is not a social welfare program. It aids in attracting and retaining a competent workforce. We have taken significant cuts in benefits over these last few years. An attractive retirement plan is about all we have left to entice people to come into government service. I would be happy to relate some of the experiences we, as managers, have had in attracting and retaining workers.

Finally, the current system offers some features that have proven to be important and valuable to the workforce. These features, such as retirement at 55 with 30 years service and unreduced benefits, calculating the benefit on the high three years of salary, and full cost-of-living adjustments, have been seen as steps forward in the design of retirement plans. Let's not move backwards by eliminating these features in the new plan. Much has been said about the high cost of our current retirement system. We seem to have lost sight of the fact that many of the retirement plans of the larger companies in this country are more generous than CSRS. We must ask ourselves whether we are seeking mediocrity or excellence in a retirement plan for Federal workers.

Senior Executives Association

TESTIMONY OF

THE

SENIOR EXECUTIVES ASSOCIATION

BEFORE THE

SENATE GOVERNMENT AFFAIRS COMMITTEE ON S-1527

TO ESTABLISH A NEW CIVIL SERVICE RETIREMENT SYSTEM

GIVEN BY

G. JERRY SHAW
GENERAL COUNSEL

BLAIR CHILDS
EXECUTIVE DIRECTOR

AND

DR. RICHARD STROMBOTNE
CHAIR OF THE SENIOR EXECUTIVES ASSOCIATION TASK FORCE

SEPTEMBER 10, 1985

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Mr. Chairman and members of the committee, we thank you for the opportunity to testify on S-1527 to establish a new retirement system for new federal employees who are now covered by Social Security. I am G. Jerry Shaw, General Counsel of the Senior Executives Association (SEA) and I am accompanied by Mr. Blair Childs, Executive Director and Dr. Richard Strombotne, Chair of the SEA Task Force on Retirement Issues.

The SEA is the professional association representing the interests of career federal executives who are responsible for directing all the programs and operations of the Federal Government under the policy guidance of political leadership and the statutory requirements enacted by Congress.

We are vitally interested in the retirement system for new employees for several reasons. First, it is our job to make sure that we attract and retain high quality employees whom we are responsible for managing. Second, we believe it is important for the government that the new system be sufficient to insure continuity of federal operations, as well as insure that citizens of this country are willing to make a career commitment to public service. Third, the new retirement system will directly affect future senior executives and possibly current executives and employees who decide to transfer to the new system, and therefore will affect the ability of the government to attract and retain top notch career managers and executives.

The Senior Executive Service (SES) was established by the Civil Service Reform Act (CSRA) in order to provide a cadre of career executives who were professionals in their occupation, who would provide continuity in government operations, and who were available to be placed by their agency in positions which the political leadership deemed important. Members of the SES gave up most of their job protections that other government employees retained in the CSRA in order to be judged on their performance and to be rewarded or removed from the SES on the basis of their continued performance.

When the SES was established over 95% of the career executives in government voluntarily entered the system. They did so because they believed there were greater challenges, and they were willing to compete to stay in the SES on the basis of their performance. A bonus and award system was set up to reward these outstanding individuals who excelled at their profession, but the implementation of such a system has been very slow.

A retirement system is an extremely important part of the compensation package which the government must rely on to attract career executives into the SES and to retain them there for the remaining years of their career. Every study made of compensation between career SES members and the private sector shows that they are woefully underpaid for the amount of responsibility and the importance of their duties in comparison to private sector executives at similar levels. In fact, over 50% of the career SES members who voluntarily entered the SES in 1978 have since resigned or retired from the SES. Those who have remained, and those who have entered the SES have done so in large part because of the retirement system currently in place. A new retirement system which does not have the attractiveness of the current retirement system could be a major disincentive to attracting quality people to the ranks of the career SES. It is imperative that the new system that is in place be sufficient to attract and retain executives who can carry out the complex missions of the Federal Government. We think the outlines of such a system are contained in this legislation, but we emphasize at the outset that without the capital accumulation plan that is contained in this bill, it would not meet the goal of attracting good people.

Before commenting on the specifics of this bill, I want to express our appreciation to Senators Stevens and Roth for their leadership and efforts over the past years to deal with the very complicated issue associated with the design of a new retirement system which is fair to employees and which is seen to be fair by all involved.

OVERALL POSITION ON STEVENS/ROTH BILL

We strongly support the philosophy that the new retirement system should follow the best private sector practice in most respects, with a few exceptions appropriate for a staff retirement system of the nation's largest employer. The GAO report of June 1984 on features of private sector retirement systems is an excellent source of information and evaluation. It is important to note that the Federal Government, as an employer of predominately professional, technical and administrative personnel, is generally competing with the largest companies and organizations in the country for talent, not with the smallest.

We support the overall design of the new retirement system so long as it includes all of the three principal components. It is imperative that Social Security coverage be supplemented by a non-contributory defined benefit plan, and a voluntary tax deferred CAP with one to one employer matching of an employee's contributions up to some limit.

The new retirement system should permit the employee who has devoted a full career of 30 years to public service, and his spouse, to maintain the same standard of living after retirement as they had before retirement. As you know, benefits under Social Security are tilted toward the employee with lower lifetime earnings. That is, the percentage of final pay replaced by annuities under Social Security is much greater for lower paid employees than it is for higher paid employees. By contrast, the current Civil Service Retirement System (CSRS) provides annuities that replace the same percentage of final average pay for both higher paid and lower paid employees having the same age and length of service. As proposed, the defined benefit plan portion is simply added on to the benefits of Social Security. There would be a very large disparity in retirement income at age 62 for the 30 year career high income employee under this proposal without the CAP. For example, the employee with $60,000 final salary would receive 10% of final pay from Social Security while the employee with $30,000 final salary would receive 18% of final salary. Even with the defined benefit portion of the plan added to Social Security, the higher paid career employee would receive only 37% of final pay in pension if the CAP was not in place. Attached to our testimony is a chart by the Congressional Research Service setting forth relative disparities between the lower paid employee and the higher paid employee utilizing Social Security and the defined benefit plan.

Approximately 90% of private firms utilize what is known as an off-set plan to eliminate part of the Social Security "tilt". They integrate the defined benefit component with Social Security so that replacement rates for lower and higher compensated employees are substantially the same. The current bill does not employ an off-set to compensate for the Social Security "tilt", but instead establishes the CAP to do so. It is absolutely imperative that the CAP proposed in this legislation remain strong or the government will be at a serious disadvantage in competing for higher paid executive, managerial, professional and technical talent. This is particularly true when one considers that the recent HAY study reports that federal employees lag behind their private sector counterparts by about 10% in overall compensation. This disparity is even more severe for executives where it is been found that "total cash compensation would have to be increased 58.4% to equal aggregate private sector total cash compensation". We cannot endorse strongly enough the CAP plan as the only acceptable alternative to not using an off-set to the Social Security "tilt".

SEA strongly opposes the CPI minus 2 COLA adjustment for the defined benefit plan portion of the proposed retirement system. We feel that a full COLA is necessary as an essential part of the compensation system. For a career executive, a substantial amount of his/her retirement income under the proposed bill would, of necessity, come from investment in the CAP. Since Social Security would make up a very small portion of the replacement rate, the COLA on Social Security would be a very small protection for higher paid executives. Since there would be no cost of living protection on the CAP and if there was a reduced COLA on the defined benefit portion, executives, as well as members of Congress, would have little protection against substantial erosion of their retirement benefits over a normal retirement span.

The people most harmed by a CPI minus 1 or 2, or a percentage of CPI on the defined benefit portion of the plan would be those in the middle and senior levels of government and in the technical positions. This is exactly the area where government has the most difficulty recruiting and retaining employees currently.

The provision for optional, normal retirement at age 55 (or greater) for an employee with ten or more years of service, but less than 30 years of service, with a penalty of 5% per year for each year before age 62, is commendable. It would provide employees with a wider range of choices, at no cost to the government, and we support it.

We recognize that the penalty of 2% per year for each year before age 62 that would apply to normal retirement (or involuntary retirement) conforms with typical private sector practice. Nevertheless, the GAO and other studies point out that some large firms permit retirement at age 55 with no penalty. In order to encourage long service employees who dedicate their professional lives to the government, we think that an employee who has served his country for 30 years should not be penalized for deciding to retire at age 55 with 30 years service. What is more, the cost of unreduced retirement at age 55 and 30 years of service is relatively small -- 1/2% of payroll. Therefore we recommend that the defined benefit plan retain the provisions of the CSRS with respect to the ability to retire without penalty at 55/30, 60/20, and 62/5.

Next, we believe that provisions of the bill regarding benefits to survivors of employees and annuitants are quite inadequate. Survivor benefits are very important considerations for employees. The availability and level of benefits to survivors in the new system should not be less than in the current CSRS.

Moreover, the provision of the current CSRS for joint and 50% survivor annuity at a cost of 2 1/2% reduction in the first $3600 of annual annuity payments and 10% of annual payments above $3600 should be retained in the new system and used as the basis for any further actuarial adjustment needed for other options. It is a reasonable balance between the individual employee having to completely fund the survivor annuity and the employee having to fund none of it.

We strongly support the one-to-one matching ratio for contributions to the tax deferred CAP which will provide a strong incentive for a high percentage of all new employees to participate. The five percent limit provides these employees with an opportunity to save for additional retirement benefits as they see their own needs. It is particularly important that the higher paid half of the employees have access to such a plan to compensate for the Social Security "tilt". We advocate permitting a higher percentage of salary be invested in the CAP than the proposed 10%.

Virtually all employee groups in the country potentially have access to some kind of tax deferred retirement savings plan whether it is 403(b), 401(k), 457, a Keogh plan or a defined contribution plan. Indeed, even non-profit organizations can provide 40k(k) or in some instances a 403(b) profit sharing plan for their employees, as the April 29, 1985 issue of Forbes points out. Federal employees are virtually the only major group of employees that have not been included as yet. We recommend that all federal civilian and military employees be provided with the opportunity to contribute to a tax deferred CAP, not limited to the new employees, and that the contribution limit be set at 20% of statutory pay. This change would remove an oversight that has become a gross inequity. Note that we are not recommending any employer matching of an employee's contributions, except in the new retirement system.

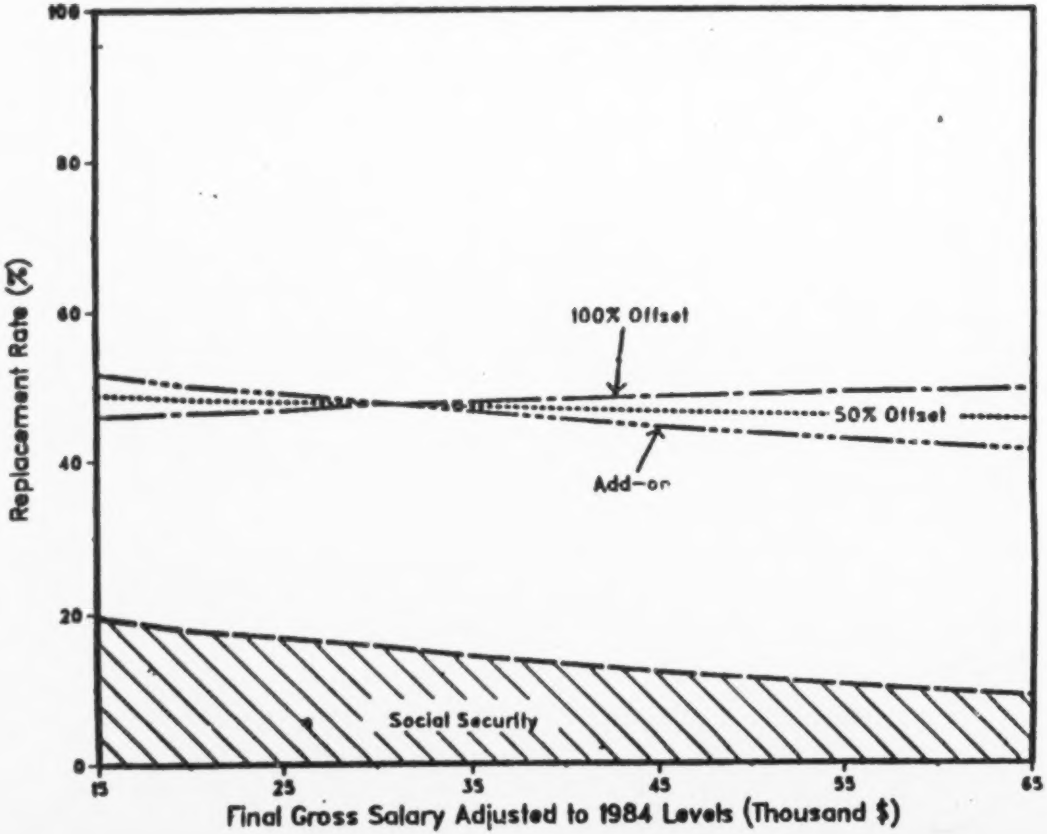
In consideration of how the new retirement system is to be administered, it is apparent that the defined benefit component can be viewed as a variation on the current CSRS and that OPM is the appropriate agency to administer it. The new CAP is, or should be, a different matter. We recommend that a separate independent organization be formed to administer the CAP for the benefit of its participants, that is, current and past employees and annuitants.

In addition, careful attention needs to be given to the appointment authorities and to organizational matters to ensure that the administration is performed objectively, fairly, and without partisan bias.

CONCLUSION

Mr. Chairman, this concludes our prepared testimony. Thank you again for giving us the opportunity to discuss the Stevens/-Roth bill today. We will be happy to work with your staff to develop these recommendations further or to discuss other topics concerning the retirement system for federal employees generally or for senior executives specifically. If you have any questions now, my colleagues and I will be pleased to respond.

FIGURE 1-4.—Backdrop Plan Variations: Comparison of Three Coordination Approaches—Single Worker Age 62 With 30 Years of Service



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NATIONAL COUNCIL

SOCIAL SECURITY MANAGEMENT ASSOCIATIONS, INC.

BEFORE THE

CIVIL SERVICE, POST OFFICE, AND GENERAL SERVICES SUBCOMMITTEE

OF THE

GOVERNMENTAL AFFAIRS COMMITTEE

U. S. SENATE

SEPTEMBER 10, 1985

Mr. Chairman, we thank you for the opportunity to testify on S1527, a proposal to establish a new civil service retirement system for those employees who entered the federal service after January 1st, 1984.

We lack the expertise to examine the actuarial projections of the proposed legislation, and thus will only make comments concerning certain principals that the bill establishes for the new retirement system.

The bill would provide a very high replacement level for lower grade employees who retire at age 62 with 30 years service. If the employee was to participate fully in the CAP program portion of the bill, the replacement rate at retirement at age 62 with 30 years of service for a $20,000 per year employee would be approximately 69 percent. For a higher paid employee, whose average salary was approximately $48,000 a year, the replacement rate if fully participating in the CAP program, would be approximately 55 percent. While the replacement rate would vary depending upon the amount of participation in the CAP program, the projected replacement rate of salary would still be substantially in excess of 50 percent for lower grade employees and could be substantially less than 50 percent for the higher paid employees. This further increases the problem of retention in management where the comparability gap increases with grade. Managers would support disporportionately in compensation, both while working and in retirement.

We do not object to the replacement rate for lower grade employees being as high as is projected in this plan. However, we believe that the salary replacement level should be the same for all employees at all grade levels. This could be achieved under the defined benefit portion of the plan by providing employees at higher grade levels, for example, GS-11 or above, with additional contributions from the employer. It could also be accomplished by providing for higher matching contributions from the government for contributions made to the CAP program by higher grade employees. Lacking the expertise to propose a solution to this dilemma, we request that the Congressional Research Service make the calculations and evaluate the cost of providing the same replacement rates for higher grade employees as those that will be received by lower graded employees. This is imperative in order to retain senior managers and executives in government. Our main concern as federal managers is that recruitment and retention problems will increase and we will be rendered unable to perform the functions entrusted to the Federal Government.

If the Congress decides that there should be any kind of offset for Social Security credit on retirement annuities, we strongly recommend that such offset only take into consideration the Social Security benefits earned during federal service. For short term federal employees, to offset Social Security earned in other employment against defined benefit plan annuities would be totally unfair, and could reduce their annuity to nearly nothing.

We strongly recommend that retirement be made available without reduction at age 55 with 30 years of service. We recognize that on average federal employees work until nearly 60 years of age, which is similar to the private sector. However, few employees either in government or out of government spend 30 years with a single employer. Those who do, should be rewarded for their continuous and dedicated service to the government and should be granted an annuity at age 55. At present, federal employee pay levels are not competitive, health insurance coverage is lower than comparable private sector offerings, and other fringe benefits are being proposed for reduction. One of our grave concerns is that this situation, coupled with a retirement system which does not reward an employee for length of service, will induce a dramatic rate of turnover in the rank of mid-level management. There has to be some incentive for a federal employee to choose public service as a career and to stay with that career during their working years. If Congress decides to treat federal employment as just another career, then all pay and benefits should be competitive with the private sector in order to retain quality managers at the middle and senior grade levels. We think that retirement at 55 years of age with 30 years of service would provide an incentive for people who are committed to public service to stay, even though they might be able to gain more pecuniary benefits from private sector employment.

We are adamantly opposed to a COLA minus 2 or any other COLA reduction provision. As Social Security managers, we have seen the results of a lack of cost of living increases in benefits prior to Congress enacting that protection for elderly people. A 2 percent per year reduction in COLA protection for an individual retiring at either 55 or 60 could cause as much as 40 to 60 percent reduction in purchasing power within 15 years after retirement. It is in an annuitant's later years that they need the protection of COLA's because they have no alternative other than the annuities that they receive. They are often elderly or sick and unable to obtain meaningful employment to supplement the annuities they receive and thus are generally totally reliant on their retirement income. In the long run, the government would probably pay more in welfare and other benefits as a result of COLA reductions than they would save by a COLA minus 2 or some other partial COLA percentage formula.

With these modifications, we could support the proposed legislation. We would like very much to work with you, Mr. Chairman, and the members of the committee and staff in order to achieve passage of this legislation.

Thank you very much for the opportunity to testify, and we would be happy to answer any questions you might have.

Senator GORE. Our next panel of witnesses includes Bruce Henry, president and executive director, National Association of Air Traffic Specialists, accompanied by Edward Huie; and Lt. Gen. LaVern Weber, executive director of the National Guard Association of the United States.

I might say, the witness list had included Thomas Doyle executive vice president of the Federal Law Enforcement Officers Association, as a member of this panel, but at the last minute, Special Agent Doyle was called on to duty for a work assign ment that was unexpected. In the nature of his business, that is an occupational hazard and we fully understand and we will have his statement included in full in the record.[1]

Senator GORE. I would like to make just a brief personal statement before this panel begins. That is by way of apologizing to you and the witnesses immediately following you because I will not be able to be here. Normally we break between 12 and 2 and I have something that I absolutely cannot get out of. I fully support the chairman's determination to continue through the day in order to make certain we complete these hearings, and I want to assure you and the witnesses immediately, following that I will read your statements very carefully and the interchanges you have with Senator Eagleton; and I know that Senator Stevens is going to do the same because he and I have talked about it. I apologize for having to leave.

My distinguished senior ranking member here is going to take over.

Senator EAGLETON [presiding]. Thank you, Senator Gore. Gentlemen, you may proceed.

TESTIMONY OF BRUCE B. HENRY, PRESIDENT AND EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF AIR TRAFFIC SPECIALISTS, ACCOMPANIED BY EDWARD L. HUIE, DIRECTOR OF LEGISLATIVE AFFAIRS; AND LT. GEN. LA VERN E. WEBER (RETIRED), EXECUTIVE DIRECTOR, NATIONAL GUARD ASSOCIATION OF THE UNITED STATES

Mr. HENRY. Mr. Chairman and distinguished members of the committee, I am grateful you have provided me with the opportunity to appear before you and to express my thoughts and opinions relative to early retirement benefits for air traffic control specialists [station]. I am accompanied by Mr. Edward L. Huie, our director of Legislative Affairs.

We believe that the issue we are bringing before you is one of air safety and fairness. I will limit my comments to this simple issue, and this is a summary of my entire statement which I would like to submit for the record.

Senator EAGLETON. All statements will be printed in the record in their entirety. That covers every witness.

Mr. HENRY. Flight service is an integral part of the air traffic control system and there are about 317 flight service stations throughout the United States. The personnel who staff the air traffic control system are designated by the Office of Personnel Management as series 2152 and are called: air traffic control specialists [station].

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[1] See p. 930.

This category is the least understood of all the categories because of the lack of term standardization and the widespread use of colloquialisms. FAA, and others as well, confuse the issue by referring to this category as flight service specialists, specialists, flight service station specialists, station specialists, station personnel, station controllers and controllers. It is so confusing that uninformed persons sometimes infer that these are the personnel who fuel and maintain aircraft. For our organization, this is an overwhelming educational burden.

The two other categories are air traffic control specialists [terminal] and air traffic control specialists [center].

This association is designated by the Secretary of Labor as the exclusive representative of all the bargaining unit members who are air traffic control specialists [station], series 2152.

Personnel in all three categories are frequently called "controllers" by FAA and others as well, and one might infer that they actually control aircraft in the ordinary sense of the word "control." Federal Aviation Administration Regulation 91.3(a) clearly states: "The pilot in command of an aircraft is directly responsible for, and is the final authority as to the operation of that aircraft."

If responsibility for operation of the aircraft is vested in the "pilot in command" as the FAA has prescribed, then control and separation can only be exercised by the pilot and not by an FAA employee located on the ground in some faraway place using a radarscope, an inexact instrument at best, even when operating at peak efficiency.

On such a basis we do not believe that responsibility can be shared for the safety of that aircraft, and we believe that control can only be exercised in the cockpit.

This is not to say that the FAA employee on the ground has no responsibility, for he does have the responsibility for carrying out the assigned duties of that position which are to provide information, issue clearances, make recommendations and to warn the pilot of other objects in the area as seen on his radarscope or as visually sighted. He cannot in anyway interfere with the prerogatives of command, which can be no less than absolute.

The statement of mission and function of flight service deserves careful study for it contains requirements of an emergency nature, such as: Assist pilots in distress; work with search and rescue units in locating missing aircraft; assist lost aircraft and aircraft in emergency situations; and advise Customs and Immigration of transborder flights including drug and narcotics interdiction.

It is very significant that 45.7 percent of all flight assists in the air traffic control system were made by air traffic control specialists [station], while flight service was endowed with only 18 percent of the total personnel positions in the entire system. To us, this looks like our people work in an environment where there are more opportunities to provide assistance for safe flight.

Flight assists are usually emergency situations where the pilot, passengers and aircraft are in jeopardy.

We believe that emergency situations create a tense working environment which requires the utmost from the journeyman in time-critical situations where superior judgment is required.

In this matter, we believe that the Federal Aviation Administration itself has expressed the strains upon the air traffic control specialists [station] far more eloquently than we ourselves can express it. An FAA attorney, before the Merit Systems Protection Board, stated relative to a flight service position: "There are few jobs that require more alertness of mind, more sound judgment [sic], the ability to assimilate information, and the ability to make split second decisions. The stresses and the strains of the job are incalculable. And there are very few people who can perform in that position."

In January 1985, the National Transportation Safety Board published a report setting forth the stark body count of fatalities in aviation over the past 10 years.

It is noted that hours flown in general aviation are 5 times greater than hours flown for the scheduled carriers, and fatalities are 13 times greater. Moreover, general aviation operates about 100 times the number of aircraft.

The FAA prefers to deal in fatality rates per 100,000 hours flown. This produces minuscule results. We, however, prefer to set for forth fatality count, which we believe is a better measure of safety and does not include hundreds of thousands of very safe hours flown. The real hazards to aviation are weather, landings, takeoffs, and low altitude flying. This is the area of General Aviation operations.

From all this, we can only conclude that air traffic control specialists [station] experience physical and mental strain and hardship in the workplace and that the work is unusually taxing and extremely stressful, perhaps more than any other part of the air traffic control system.

It is for these reasons that the Secretary of Transportation in implementation of 5 U.S.C. 5542, included air traffic control specialists [station] within the provisions of that law, which states: "The duties of which are critical to the immediate daily operation of the air traffic control system, directly affect aviation safety, and involve physical or mental strain or hardship; * * *"

Not only has the Secretary of Transportation determined that air traffic control specialists [station] are covered by 5 U.S.C. 5542, but also, the Secretary has reaffirmed this determination every pay period since the enactment of the law.

Similarly, permissive premium pay is authorized in the continuing appropriations for fiscal year 1983 and includes flight service station specialists.

We, accordingly, hold that the community of air traffic control specialists [station] is a unique group of Federal employees which, by law, is worthy of special consideration, and that exclusion of this group from early retirement benefits accorded to other air traffic control specialists of the same 2152 designation and covered by 5 U.S.C. 5542 and Public Law 97-276, constitutes unfair and inequitable treatment.

On June 26, 1985, Hon. Gene Taylor, testifying before the Subcommittee on Compenstion and Employee Benefits of the House

Post Office and Civil Service Committee relative to early retirement for flight service station specialists and his bill, H.R. 989, stated:

> If fairness and equity in the workforce is to be achieved and if aviation safety is to be enhanced, we have no alternative but to include the air traffic control specialists in stations within the group entitled to early retirement and remove the stigma of separateness from these loyal and dedicated Federal employees.

The issue is one of fairness and equality, and our community of specialists have been second-class citizens since the passage of Public Law 92-297, and they consider themselves as such.

It is axiomatic that all personnel in the same personnel category must be treated equally and fairly if high morale, good order, and discipline are to be achieved. This is not the case in the air traffic control community where there exists a caste system of noblemen and serfs.

In conclusion, we quote the chairman of the Subcommittee on Investigations and Oversight of the House Committee on Public Works and Transportation, in his hearing record on "The Impact of Weather on Aviation Safety":

"It became pretty clear that the message being given by all the witnesses is that suspect weather cells should be avoided just as one aircraft should avoid the path of another aircraft."

Mr. Chairman and members of this committee, we urge that air traffic control specialists [station]—flight service personnel—be provided the same early retirement opportunities as are accorded other air traffic control specialists of the same series 2152 designation.

Thank you, Mr. Chairman.

Senator EAGLETON. Thank you. Why don't we go with all the statements and then I will get into questioning later.

General Weber.

General WEBER. Mr. Chairman, members of the committee, I appreciate the opportunity to be appearing before you today to present the views of the National Guard Association of the United States on the provisions of the Civil Service Pension Reform Act, S. 1527.

I am accompanied today by Col. Chuck Schreiber, a member of our association staff.

The association supports the overall design of the proposed retirement plan, which utilizes a three-tier system of Social Security, a defined benefit plan, and a thrift savings plan. We are especially appreciative of the concern shown by this committee for the nearly 47,000 military technicians who, by law, must maintain military membership in the Army and Air National Guard as a condition of their Federal civil service employment, and are subject to mobilization and deployment in their military status.

We generally support the bill, but the association does have several concerns relating to specific provisions applicable to military technicians, as we understand the bill will be written.

In passing the National Guard Technicians Act of 1968, Congress anticipated that the eligibility requirements of age 55 with 30 years service for an unreduced annuity would blend well with a technician's military career. This assumption has been proven correct. We fully support continuation of this criteria, and appreciate the committee's inclusion of such a provision in the new retirement plan.

In 1968, Congress also recognized that the military retention laws would make the discontinued service retirement provisions, at age 50 with 20 years service or at any age with 25 years service, a key factor in the technician program. For example, military separations often occur between the ages of 53 to 55, due to the retention provisions of the Reserve Officer Personnel Act and the Department of Army and Department of Air Force policy.

Even though such individuals take a 2-percent reduction in annuity for every year under age 55, this concept has caused relatively few problems and has proven to be harmonious with the technician's military career.

The National Guard Association believes that the proposed increase in penalty reduction from 2 to 5 percent for each year under 55 will have a drastic impact on those technicians who, unlike other Federal employees, lose their Federal civil service employment when loss of military membership occurs. Full consideration must be given to the effect of loss of military membership on a technician's civil service employment. We urge the committee to reconsider this portion of the bill and continue the 2-percent provision. We understand the staff has given favorable consideration to this issue and we appreciate that very much.

Mr. Chairman, the National Guard Association has one additional important area of concern. You have stated that the prooosed legislation is intended to encourage employees to remain for a full career, to maintain the standard of living for a career employee into retirement, and to provide good benefits while restraining costs. We feel the bill establishes an excellent vehicle for accomplishing these goals, through the establishment of the three-tier system. However, the association is seriously concerned about the possible absence of one of the tiers during an extended period immediately following a military technician's retirement.

The new plan relies on the Social Security tier to provide a substantial portion of the employee's retirement income. The absence of this tier for any period would significantly reduce the retiree's overall annuity and would certainly preclude continuing the employee's previous standard of living into retirement.

The necessity to provide for retirement prior to eligibility for a Social Security annuity has been recognized for special retirement classes, such as law enforcement officers, firefighter, and air traffic controllers. Provisions for revised retirement eligibility criteria and an annuity supplement until age 62 are included in the bill. The annuity supplement equates to the Social Security tier which is not available from the date of retirement until age 62.

This association urges the committee to consider a change to the bill to provide for an annuity supplement for military technicians similar to that provided for law enforcement officers, firefighters, and air traffic controllers. The bill recognizes the special circumstances of the military nature of the dual-status National Guard technician by providing for a fully defined benefit annuity retirement at age 55. We have discussed the need for a 2-percent penalty rather than 5-percent provision, because of the possible early loss of military membership and the resultant involuntary termination of Federal employment. We also feel that the demands for physical ability, coordination and stamina of the military technician are similar to those of the other special retirement classes.

Mr. Chairman, parenthetically, permit me to remind all that National Guard military technicians are subject to mobilization with their unit on very short notice and to deploy to any part of the globe in support of a national emergency. These conditions make those demands of physical ability, coordination, and stamina even more significant.

Under the current provisions of the bill, a National Guard technician would be penalized for early retirement mandated by the military relationship of his employment. For example, a technician who is forced to retire at age 53, due to loss of military membership, would not receive a critical portion of his total retirement annuity for approximately 9 years.

Senator **Eagleton**. Would you explain that previous sentence to me again, General?

General **Weber**. If one of our technicians, and frequently this is the case, is forced to retire by loss of military status, and consequent loss of his techician status, he will go 9 years without the Social Security tier being provided.

Senator **Eagleton**. What forces him out at 53?

General **Weber**. We have a Reserve Officer Personnel Act which forces out officers at certain points of years of service and age, a combination of those. In the case of both the Army and the Air Force, policy matters, not a matter of law, require mandatory screening of all military personnel again to meet those conditions that I outlined earlier, the physical stamina and the ability to be mobilized.

Senator **Eagleton**. Let's take this fellow then. He is forced out at 53. What does he get in the three tier now? Take me through this. What tier does he lose?

General **Weber**. The Social Security.

Senator **Eagleton**. He has no Social Security from 53 to 62. So for 9 years, he is minus that portion of the plan?

General Weber; Yes, sir. And under the plan, as we understand your plan, he does not get a supplement.

Senator **Eagleton**. And does not get a supplement that the controllers would get?

General **Weber**. Yes, sir.

Senator **Eagleton**. So that category or group of folks, they are double-whammied, aren't they?

General **Weber**. Yes, sir.

Senator **Eagleton**. I ask my staff to make a note about that. It seems to me on initial hearing or impression it doesn't sound fair to me. We certainly ought to look into that. How many people might this affect in a given year?

General **Weber**. In a given year we have about an 8-percent turnover on 47,000 that is something like 3,600, give or take a few. Of that 3,600, about a third, or just a few over a thousand, go into retirement, voluntarily, involuntarily, or on physical disability.

Senator **Eagleton**. What would be the average age of those people?

General **Weber**. The average age in that category would come out about 54.6 years of age based on the best figures we could get.

Senator **Eagleton**. Do this for me when you go back to your office, make me up some real life cases—you don't have to put any names on them, Mr. X, Mr. Y, Mr. Z—and show me what that might mean compared to a controller. If the controller is forced out—of course, under Senator Stevens' bill, there is no mandatory retirement, am I right, for controllers? Under present law there is, age 55, 56.

Mr. **Huie**. Fifty-six.

Senator **Eagleton**. Under present law, 56 mandatory. Under the Stevens' bill no mandatory.

Mr. **Huie**. It is permissive with the Secretary.

Senator **Eagleton**. Permissive.

Mr. **Huie**. He can go to 61.

Senator **Eagleton**. He can waive it?

Mr. **Huie**. The Secretary can depending upon the needs of the service.

Senator **Eagleton**. Let's say a controller under the Stevens' bill goes out at 55. He doesn't get Social Security?

Mr. **Huie**. Under the existing system, sir?

Senator **Eagleton**. Under Senator Stevens' bill, he can't get Social Security.

Mr. **Huie**. He gets a supplement which is equal to what——

Senator **Eagleton** [interposing]. I'm tracking now.

I am wondering why we get this double penalty to your folks, General.

General **Weber**. In all fairness, sir, let me tell you we have surfaced this with the staff and we have gotten a favorable response.

Senator **Eagleton**. Give us Mr. X, Mr. Y, Mr. Z. Let's make him a controller on the one hand, real cases, compared to your folks on the other hand. Let me just look at what it means in the real life income, monthly income or annual income, however you want to show it to us, of these two individuals, if both are going out about the same time and one fellow is getting *x* dollars in his pocket and the other fellow is getting *x* moneys.

[The information referred to follows:]

COMPARISON OF RETIREMENT ANNUITY FOR NATIONAL GUARD MILITARY TECHNICIANS AND AIR TRAFFIC CONTROLLERS

							National Guard Technicians		Air Traffic Controllers
CASE	GRADE	AGE	YEARS OF SERVICE	HIGH-3 SALARY	HIGH-5 SALARY	ANNUAL RETIREMENT ANNUITY UNDER PRESENT SYSTEM	ANNUAL ANNUITY UNDER S.1527 DEFINED BENEFIT PLAN	ANNUAL SOCIAL SECURITY SUPPLEMENT	DEFINED BENEFIT WITH SUPPLEMENT
A	GS-09	55	30	$28,300	$26,800	$15,848	$8,040	$5,628	$13,668
B	GS-12	56	32	$35,000	$33,500	$21,000	$10,720	$6,365	$17,085
C	GS-07	53	28	$20,200	$19,000	$10,084	$4,788	$4,940	$9,728
D	GS-10	54	25	$25,500	$24,100	$11,496	$5,724	$5,543	$11,267
E	GS-08	50	20	$22,300	$21,000	$7,226	$3,150	$4,200	$7,320

Figures do not include reduction for survivor annuity, health benefits or life insurance, nor an increase for an estimated thrift plan annuity.

Senator EAGLETON. Pardon me, gentlemen, go ahead. You may continue.

General WEBER. Our association believes it is the Federal Government's responsibility to ensure that these dual-status technicians receive fair and reasonable compensation for their years of faithful and dedicated service. We strongly support a change in the bill to provide an annuity supplement from the date of retirement to age 62.

In summary, the National Guard Association of the United States looks forward to offering its support for the proposed new three-tier retirement plan. We solicit the committee's support in revising the plan to decrease to 2 percent the reduction for those National Guard techicians who are involuntarily terminated prior to age 55 and to provide an annuity supplement from the date of retirement until age 62.

Mr. Chairman, the National Guard Association is deeply appreciative of the positive support you, the members of this committee and the Congress continue to give to the members of our association. I wish to thank you for the opportunity to present the views of the National Guard Association. I look forward to working with your staff and members of this committee on this important issue.

Senator EAGLETON. Mr. Henry, while I am collecting my thoughts up here, did you in your prepared testimony address the COLA question?

Mr. HENRY. No, sir; we did not.

Senator EAGLETON. What is your position on the proposed Stevens COLA?

Mr. HENRY. Sir, we support the existing COLA's.

Senator EAGLETON. Were you present in the room when I was here earlier in the day talking about the 1.3-percent issue as to where that 1.3 percent might be placed, whether in the defined benefit plan as is recommended by some of the previous witnesses or in the thrift plan?

Mr. HENRY. Yes, I was present.

Senator EAGLETON. Can you give us your comment on that question?

Mr. HENRY. Unfortunately, Senator, I haven't polled my membership on this issue. I have a personal opinion. I would agree with the thrift plan——

Senator EAGLETON [interposing]. Your personal opinion is it would be better placed in the thrift?

Mr. HENRY. That's correct.

Senator EAGLETON. General, how about you?

General. WEBER. We were just chatting on the same issue, sir. We did not have it in our prepared statement but we would probably agree with the thrift savings, as we feel it would better compensate.

Senator EAGLETON. Mr. Henry, the Stevens thrift plan provides dollar-for-dollar up to 5 percent of salary. Do you support that?

Mr. HENRY. Yes, I do.

Senator EAGLETON. Any dimunition thereof you would not support?

Mr. HENRY. I would say that would be fair.

Senator EAGLETON. The better the thrift, the more you like?

Mr. **Heney**. That would be fair.

Senator **Eagleton**. How about you, General?

General. **Weber**. I would agree with that position, sir.

Senator **Eagleton**. What is the average length of service, Mr. Henry, of your people at the time of retirement?

Mr. **Henry**. The average flight service specialist retires at age 57 with 30 years of service.

Senator **Eagleton**. 57 with 30. General, do you have any figures on that question?

General. **Weber**. We are very close to the 55.

Senator **Eagleton**. You are close to the 55?

General. **Weber**. Yes, sir.

Senator **Eagleton**. With what service?

General. **Weber**. Most of those are with 30 years. That's our experience right now, sir.

Senator **Eagleton**. Pretty close to 30, you say?

Thank you gentlemen, we appreciate it very much.

[The prepared statement of Messrs. Henry and Weber follow:]

NAATS
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STATEMENT

before the

COMMITTEE

ON

GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

Ninety-ninth Congress

Chaired by

THE HONORABLE TED STEVENS

on

BENEFITS FOR AIR TRAFFIC CONTROL SPECIALISTS (STATION) EMPLOYEES OF THE FEDERAL AVIATION ADMINISTRATION DEPARTMENT OF TRANSPORTATION

by

BRUCE B. HENRY
PRESIDENT & EXECUTIVE DIRECTOR
NATIONAL ASSOCIATION OF
AIR TRAFFIC SPECIALISTS

September 10, 1985

Mr. Chairman and distinguished Members of this Committee, I am grateful that you have provided me with the opportunity to appear before you and to express my thoughts and opinions relative to early retirement benefits for Air Traffic Control Specialists (Station). I am accompanied by Mr. Edward L. Huie, our Director of Legislative Affairs.

We believe that the issue before you is one of air safety and fairness.

The Flight Service System is an integral part of the Air Traffic Control System and there are about 317 flight service stations throughout the United States. The personnel who staff the Air Traffic Control System are designated by the Office of Personnel Management as Series 2152 and are called:

. Air Traffic Control Specialists (Station)

This category is the least understood of all the categories because of the lack of term standardization and the widespread use of colloquialisms. FAA, and others as well, confuse the issue by referring to this category as Flight Service Specialists, Specialists, Flight Service Station Specialists, Station Specialists, Station Personnel, Station Controllers and Controllers. It is so confusing that uninformed persons sometimes infer that these are the personnel who fuel and maintain aircraft. For NAATS, this is an overwhelming educational burden. An example is included as Attachment (1) hereto (FAA news release dated March 5, 1985 -- FAA 10-85).

The two other categories are:

. Air Traffic Control Specialists (Terminal)

. Air Traffic Control Specialists (Center)

This Association is designated by the Secretary of Labor as the exclusive representative of all the bargaining unit members who are Air Traffic Control Specialists (Station) Series 2152.

Personnel in all three categories are frequently called "Controllers" by FAA and others as well, and one might infer that they actually control aircraft in the ordinary sense of the word "control." Federal Aviation Administration Regulation 91.3(a) clearly states: "The pilot in command of an aircraft is directly responsible for, and is the final authority as to the operation of that aircraft".

If responsibility for operation of the aircraft is vested in the "pilot in command" as the FAA has prescribed, then control and separation can only be exercised by the pilot and not by an FAA employee located on the ground in some faraway place using a radarscope, an inexact instrument at best even when operating at peak efficiency.

Additionally, we have all heard of radar "outages" in recent years, an event upon which the news media thrives. We often wonder how the media finds out about "outages" so quickly. Of course, when there is an "outage", the FAA ground personnel can provide no information to the pilot at all. The Federal Aviation Administration has, therefore, wisely placed all command, control and separation squarely on the shoulders of the pilot because there is no other place where this awesome responsibility can be lodged.

On such a basis we do not believe that responsibility can be shared for the safety of that aircraft, and we believe that control can only be exercised in the cockpit.

We can provide no better example of this than the near miss between two jumbo jet aircraft on March 31, 1985, at Minneapolis, Minnesota, with a combined total of 500 people aboard. While the National Transportation Safety Board has not rendered its report, Chairman Burnett and other Safety Board personnel have been widely quoted by the news media. "Both crews were executing the air traffic control instructions they were provided, no question", according to Michael O'Rourke, investigator in charge for the Safety Board.

However, one pilot in command disregarded the "controller instructions" and acted on his own and within his authority and responsibility. He avoided what could have been a disaster reminiscent of the world's worst aviation disaster, where 577 people were killed in Tenerife, Canary Islands, in 1977 in a similar crossing situation.

This is not to say that the FAA employee on the ground has no responsibility, for he does have the responsibility for carrying out the assigned duties of that position which are to provide information, issue clearances, make recommendations and to warn the pilot of other objects in the area as seen on his radarscope or sighted visually. He cannot in any way interfere with the prerogatives of command, which can be no less than absolute.

Nevertheless, we have heard in past hearings, and probably in this one as well, the FAA witness state that station personnel are not qualified for early retirement because they do not control and separate aircraft. We hasten to add that no FAA employee on the ground controls and separates aircraft with the exception of the operation of a drone aircraft (no pilot) and, in this case, control is exercised from a ground position or from another vehicle. An example of this was the recent intentional crash of FAA aircraft in the desert for reasons of research. In that specific case, FAA employees on the ground did, in fact, exercise the prerogatives of command, control and separation. This is the only example that has come to our attention, where control and separation have been experienced by FAA ground personnel.

In our view, commercial air carriers are not too anxious for it to be well known that their pilots in command bear the full responsibility for the aircraft. It is in their best interest to dilute and confuse the issue when it comes to public liability litigation and, if possible, involve the government as much as possible in sharing damages which may be awarded by the courts as the result of an aircraft accident or crash. This applies to the General Aviation community as well.

In FAA's recent report to the Congress entitled "FY 1985-87 Planned Office and Facility Consolidations--To Improve System Effectiveness and Efficiency", dated December 1, 1984, the functions and mission of the flight service stations are set forth as follows:

> "Flight Service Station (FSS). Flight service stations offer a broad range of pre-flight and in-flight services aimed at general aviation (or non-airline) pilots. These services include conducting pre-flight weather briefings for pilots and accepting and closing flight plans, primarily through telephone and radio communications. Additionally, FSS's provide enroute communications with pilots flying under Visual Flight Rules (VFR), assist pilots in distress, work with search and rescue units in locating missing aircraft, assist lost aircraft and aircraft in emergency situations, monitor radio navigation stations, relay air traffic control (ATC) clearances, originate Notices to Airmen, broadcast aviation weather and National Airspace System (NAS) information, receive and process Instrument Flight Rules (IFR) flight plans, and monitor radio air navigations facilities (NAVAIDS). In addition, at selected locations, FSS's provide Enroute Flight Advisory service (Flight Watch), take weather observations, issue airport advisories, and advise Customs and Immigration of transborder flights. The FSS's also have communications equipment for relaying information to air traffic towers and control centers and for various emergency services. Flight service stations are under the general direction of the regional Air Traffic Divisions and Washington headquarters."

This statement of mission and function deserves careful study:

- In the first sentence, the FAA attempts to downgrade our service by eliminating scheduled airline pilots as one of the users of flight service information. While the service may be aimed at general aviation pilots, the truth is that scheduled carriers are very frequent users of flight service products.
- The word "emergency" is used twice.

Other phrases:

- Assist pilots in distress.
- Work with search and rescue units in locating missing aircraft.
- Assist lost aircraft and aircraft in emergency situations.
- Advise Customs and Immigration of transborder flights (includes drug and narcotics interdiction--added).

It is very significant that 45.7 percent (1985 House Appropriations Hearings, Part 6, page 641), of all flight assists were made by Air Traffic Control Specialists (Station), while the system was endowed with only 18 percent of the total personnel positions in the Air Traffic Control System. To us, this looks like our people work in an environment where there are more opportunities to provide assistance for safe flight.

Flight assists are usually emergency situations where the pilot, passengers and aircraft are in jeopardy.

We believe that emergency situations create a tense working environment which requires the utmost from the journeyman in time-critical situations where superior judgment is required.

In this matter, we believe that the Federal Aviation Administration itself has expressed the strains upon the Air Traffic Control Specialists (Station) far more eloquently than we ourselves can express it. In the case of Marvin A. Miyai (an Air Traffic Control Specialist (Station)) v. Federal Aviation Administration, before the United States

Merit Systems Protection Board, at a hearing dated February 7, 1985, (Docket No. SF07528510116), Mr. Malachy T. Coghlan, for the FAA, said of Mr. Miyai's job:

> "There are few jobs that require more alertness of mind, more sound judgement (sic), the ability to assimilate information, and the ability to make split second decisions. The stresses and the strains of the job are incalculable. And there are very few people who can perform in that position."

The Comptroller General of the United States recently published a Report to the Congress, "Safety Standards on Small Passenger Aircraft," (GAO/RCED-84-2 of January 4, 1984), which is germane to the Flight Service System and sets forth the major safety problems with smaller aircraft. While the report deals specifically with small air carrier aircraft, the problems set forth are applicable, we believe, to all General Aviation aircraft. All of these are the primary customers of Flight Service. An appropriate excerpt from this report follows:

> "For a variety of reasons it is difficult to attribute an aircraft accident to any single cause or factor. According to NTSB reports, aircraft accidents generally result from multiple causes. Yet, based on the accident statistics, one fact remains clear: Flying in a small carrier aircraft is definitely less safe than flying in a large one.
>
> "How small commuter and air taxi aircraft are used obviously affects the level of safety that they can achieve. For example, small commuter aircraft average twice as many take-offs and landings per hour flown as do large air carrier aircraft (most accidents occur during take-offs and landings). Also, commuter and air taxi aircraft serve a significantly larger number of lesser equipped or remote airports than the large aircraft. Finally, small aircraft spend considerably more time operating at lower altitudes, where flying weather is often less than ideal.

"The incongruity of this situation, however, is that small aircraft, which are operating potentially under the more hazardous conditions, are being built and operated under FAA's least stringent airworthiness standards and operating rules for air carriers.

"MAJOR CAUSES AND FACTORS THAT INFLUENCE AIR CARRIER ACCIDENTS

"While we cannot draw a direct link between accidents and specific causes, our analysis of FAA accident data for the period 1975-81 indicates that the causes and factors of air carrier accidents are related to three areas:

--personnel (including pilot and flight crew and other personnel such as mechanics and dispatchers),

--environment (airports, weather, and terrain), and

--aircraft (airframe, powerplant, instruments and accessories).

"Using FAA and NTSB data and our own analyses of these data on 1,327 commuter and air taxi accidents that occurred during 1975-81, we found that about 53 percent of the accident causes and factors were personnel-related, 30 percent were related to the environment, and 14 percent were related to the aircraft."

In aviation, overall, it is estimated that forty per cent of all accidents are weather related.

To approach this from another point of view, the National Transportation Safety Board (SB 85-01 of 1/10/85) has published the stark body count of fatalities for the past ten years, as listed on the following page.

Please note that hours flown in General Aviation are five times greater than hours flown for the scheduled carriers and fatalities are thirteen times greater. Moreover, General Aviation operates about one hundred times the number of aircraft.

The FAA prefers to deal in fatality rates per one hundred thousand hours flown. This produces minuscule results. We, however, prefer to set forth the fatality count which we believe is a better measure of safety and does not include hundreds of thousands of "very safe" hours flown. The real hazards to aviation are weather, landings, takeoffs, and low altitude flying. This is the area of General Aviation operations.

FATALITIES

		U.S. Air Carriers* All Scheduled Service (Airlines) 14 CFR 121)	General Aviation** Air Taxis Commuters TOTAL	Air Taxis	Commuters	General Aviation
	1975	122	1,355	69	28	1,258
	1976	38	1,353	100	27	1,226
	1977	78	1,430	118	32	1,280
	1978	160	1,761	155	48	1,558
	1979	351	1,380	77	66	1,237
	1980	0	1,392	103	37	1,252
	1981	4	1,410	94	34	1,282
	1982	233	1,268	72	14	1,182
	1983	15	1,119	62	11	1,046
P.	1984	4	1,094	55	41	998
Total	10 yr. period	1,005	13,562	905	338	12,319

AIRCRAFT HOURS FLOWN

P.	1984	7,302,000	35,626,000	3,328,000	1,757,000	30,541,000

P. Preliminary

* About 2,200 aircraft

**Over 200,000 aircraft

Further, on February 28, 1985, the Chairman, National Transportation Safety Board, testified before the House Committee on Appropriations (Transportation) as follows:

> "Tremendous strides have been made in aviation technology in the brief eight decades of its existence, and yet aviation continues to be plagued by one of the oldest causes of accidents in the book -- weather."

From this, one might observe that the FAA is concentrating the preponderance of its personnel and material resources in the safest and least accident-prone sector of the Air Traffic Control System (e.g., scheduled carriers).

From all this, we can only conclude that Air Traffic Control Specialists (Station) experience physical and mental strain and hardship in the workplace and that the work is unusually taxing and extremely stressful, perhaps more than any part of the Air Traffic Control System.

It is for these reasons that the Secretary of Transportation, in implementation of 5 USC 5542, included Air Traffic Control Specialists (Station) within the provisions of that law. The pertinent provisions are quoted below:

> "(3) Notwithstanding paragraphs (1) and (2) of this subsection for an employee of the Department of Transportation who occupies a nonmanagerial position in GS-14 or under and, as determined by the Secretary of Transportation,
>
> > (A) the duties of which are critical to the immediate daily operation of the air traffic control system, directly affect aviation safety, and involve physical or mental strain or hardship;
> >
> > (B) in which overtime work is therefore unusually taxing; and

> (C) in which operating requirements cannot be met without substantial overtime work;
>
> the overtime hourly rate of pay is an amount equal to one and one-half times the hourly rate of basic pay of the employee, and all that amount is premium pay."

Air Traffic Control Specialists (Station) are employees of the Department of Transportation. They do occupy nonmanagerial positions in GS-14 or under. Their duties are critical to the operation of the Air Traffic Control System and directly affect aviation safety. These duties involve physical and mental strain and hardship and, therefore, overtime work is unusually taxing. Lastly, operating requirements cannot be met without substantial overtime work.

In the House Appropriations Hearing for Fiscal Year 1985, (Part 6, page 641), the FAA estimated that overtime in the Flight Service System would be 163,561 hours.

Not only has the Secretary of Transportation determined that Air Traffic Control Specialists (Station) are covered by 5 USC 5542, but also the Secretary has reaffirmed this determination every pay period since the enactment of the law.

Not only is special overtime pay for Air Traffic Control Specialists (Station) provided in 5 USC 5542, but also premium pay is provided by the Congress in the Continuing Appropriations for Fiscal Year 1983 (P.L. 97-276 Oct. 2, 1982) quoted below:

> "§5546a. Differential pay for certain employees of the Federal Aviation Administration
>
> "(a) The Administrator of the Federal Aviation Administration (hereafter in this section referred to

> as the 'Administrator') may pay premium pay at the rate of 5 per centum of the applicable rate of basic pay to--
>
> "(1) any employee of the Federal Aviation Administration who is--
>
> "(A) occupying a position in the air traffic series classified not lower than GS-9 and located in an air traffic control center or terminal or in a flight service station;..."
>
> * * * * *
>
> "(e)(1) The Administrator may pay premium pay to any air traffic controller or flight station specialist of the Federal Aviation Administration who, while working a regularly scheduled eight-hour period of service, is required by his supervisor to work during the fourth through sixth hour of such period without a break of thirty minutes for a meal.
>
> "(2) Premium pay paid under paragraph (1) of this subsection shall be paid at the rate of 50 per centum of one-half of the applicable hourly rate of basic pay."

Here again the law is permissive as to its application, and the FAA Administrator has, for good and sufficient reasons, included Air Traffic Control Specialists (Station) as a group of employees qualified for the premium pay authorized.

We, accordingly, hold that the community of Air Traffic Control Specialists (Station) is a unique group of Federal employees who, by law, is worthy of special consideration and that exclusion of this group from early retirement benefits accorded to other Air Traffic Control Specialists of the same 2152 designation and covered by 5 USC 5542 and P.L. 97-276 constitutes unfair and inequitable treatment.

Unfair and inequitable treatment is demonstrated daily by the "Second Class Citizen" label which Air Traffic Control Specialists (Station) have applied to themselves on a national basis with the attendant low morale environment which is apparent to even a casual observer.

The enabling legislation, Public Law 92-297, provided that only those GS-2152 series Air Traffic Control Specialists employed at centers and towers would be provided coverage and benefits under that legislation.

The discriminatory aspects of that legislation has divided the different categories of Air Traffic Control Specialists into the "haves" and the "have-nots" and has created a very real caste system within this safety and life-saving system.

This discrimination has escalated at all levels of the FAA and the legislation as enacted has proved to be detrimental, rather than beneficial, to aviation safety.

The cumulative effects of the discrimination by FAA, which favored one sector of its Air Traffic System workforce to the exclusion of another, has resulted in feverish attempts on the part of those covered by the legislation to protect the "private domain" interests, and they were provided with all possible aid and comfort by the FAA in continuing and expanding the area of discrimination.

The question is sometimes asked, "Can the Government be sued in aircraft accidents involving alleged negligence on the part of Air Traffic Control Specialists (Station)?". The answer to that question is in the affirmative, and there are numerous examples.

Accordingly, legal burden is upon the shoulders of every Air Traffic Control Specialist (Station) in the everyday performance of his/her duties.

While pay is not a subject of this hearing, discrimination certainly is a major subject. One only needs to refer to GAO Report "Development of the Classification Standard for Flight Service Station Specialists" (FPCD-79-52 of July 25, 1979) to find significant examples which are quoted:

> "Because of the possibility of widespread work slowdowns by controllers, the Commissioners intervened directly in the decison making process. PATCO was granted a personal hearing by the Commissioners who overturned the Standards Division's position which resulted in a one-grade increase for controllers over what the Standards Division had recommended. NAATS was also granted a personal hearing, but it was unsuccessful in its appeal for higher grades for flight service station specialists."

We hold that if the Commissioners so much as lifted a finger in response to a threat of a widespread work slowdown by "controllers", then the Commissioners were, in fact, placed in the position of condoning the commission of an intended felonious act. Air Traffic Control Specialists (Station) did not threaten the Commissioners in any way nor did they contemplate any such action.

In the Secretary of Transportation's comment on this GAO report, the Secretary stated:

> "It was the Department's and the Agency's expectations and point of view that selected air traffic control and FSS facilities should be elevated one grade level.
>
> "Although the GAO concludes, and we agree, that proper procedures were followed by the CSC, we continue to be convinced that high-volume FSS facilities should be established at the GS-12 level. Nothing in the report changes this belief or resolves this dilemma."

This GAO Report was prepared at your request, Mr. Chairman, and we are eternally grateful for your demonstrated interest in the Flight Service System.

5 USC 2109 defines Air Traffic Controller as "an employee of the Department of Transportation who is actively engaged in the separation and control of air traffic", and provides that the Secretary of Transportation may prescribe regulations or determine the application of this section. As previously argued in this testimony, we contend that no FAA personnel on the ground controls aircraft.

It is interesting to note at this time the document used by the Secretary of Transportation to implement the provisions of P.L. 92-297. It is identified as Department of Transportation Federal Aviation Administration Order 3410.11a, dated May 16, 1975, and reprinted August 30, 1976, with change 1 entitled "ATC Second Career Program".

The "Foreword" to this order, signed by the "Acting Administrator", J. W. Cochran, is quoted:

> "EXPLANATION. This order revises the ATCS Second Career Program to incorporate recommendations of the ATCS Second Career Review Committee, guidance contained in Supplemental Instruction letters issued as supplements to Order 3410.11, and recommendations from Washington and field offices."

No mention is made of retirement benefits and yet, on page 1, we find that the purpose of the order is significantly expanded:

> "PURPOSE. This order implements Public Law 92-297 which is designed to improve the conditions of employment for air traffic controllers by offering retirement benefits, job training and special appeal procedures for those who are involuntarily removed from air traffic control work; and

to establish maximum age limitations for recruitment under 5 U.S.C. 2109, 3307, and 3384."

The coverage section is of such importance that it is set forth in its entirety:

"5. COVERAGE

a. This order applies to and affords coverage for: employees of DOT with five or more years of career controller service who meet all of the following requirements; or the immediate supervisor or a nonsupervisory employee who meets all of the following requirements:

(1) Offically assigned to an air traffic control facility;

(2) Actively engaged in the separation and control of live air traffic;

(3) Occupies a position which requires him to meet on a continuing basis the physical qualification standards established by the Civil Service Commission for an air traffic controller.

b. This coverage includes and is limited to full professional level controllers and their immediate supervisors; those assigned as flow controllers; and employees receiving developmental training at or above the established entry levels as defined by the classification standards and the Civil Service examination announcement at time of entrance on duty. Also included are controllers assigned to a combined Flight Service Station/Tower where the tower duties are performed on a regular, recurring basis. Where a second level or higher supervisor is required to serve as a career controller or as the immediate supervisor of a career controller or as the immediate supervisor of a career controller performing the full range of first level supervisor duties on a regular, recurring basis for a substantial portion (e.g., 50% or more) of his time, and these duties are included in the official position description, he is covered under P.L. 92-297.

c. This coverage does not include employees temporarily assigned to control of live air traffic

> primarily for the purpose of maintaining proficiency in order to aid in the performance of their other regularly assigned duties or primarily for research, development, or evaluation purposes. Also not included are employees receiving predevelopmental training at grades below the normal entrance level, supervisors of flow controllers, and second level and higher level supervisors except as provided in item b. above.
>
> d. Decisions regarding application of coverage provisions in this paragraph will be made by the regional/center directors. This authority may be redelegated to the manpower division chief. The regional/center director, or his designee, may refer questions regarding interpretations of coverage provisions to the Director of Personnel and Training."

Not only are "full professional level controllers" included in the coverage, but also those receiving developmental training and those employees holding "flow controller" positions.

The authority for making decisions regarding coverage provisions is delegated to regional/center directors of which there are thirty-one in number. Such authority may be further delegated to "manpower division chiefs".

Accordingly, we have 62 officials who may be authorized to make decisions relative to coverage under this order. How any standard for approval/disapproval can be achieved under these conditions is indeed mysterious to us.

To look further into the implementing order, we believe the section on retirement is germane to the confusion:

"12. RETIREMENT

a. An employee who meets the service and age requirement under P.L. 92-297 has a vested right to such entitlement, which he may exercise at his option, regardless of subsequent job assignments within the Federal service. The annuity computed for employees retiring under the provisions of this order is based on the regular retirement formula with a guaranteed minimum equal to 50% of the high-3 average salary. The annuity is not reduced even if the employee is under age 55 at the time of separation.

b. In order for the Civil Service Commission to determine whether the retirement claim of an employee is governed by P.L. 92-297,it is necessary that a certification will be made by the chief of the servicing payroll branch and will be based on the determination of creditable service made by the respective manpower division chief in coordination with the air traffic division chief, as appropriate.

A completed FAA Form 3300-30, signed by the manpower division chief, or his designee, will be forwarded along with Standard Form 2801, Application for Retirement, (and any other applicable material) to the chief of the payroll branch. Based on this information, the payroll chief will make the necessary certification on Standard Form 2806, Individual Retirement Record. Where the employee claims creditable experience which is not readily determined, due to inadequate records, position descriptions, etc., the employee should seek verification of his claimed experience from his former supervisor, if available; from old records at home or elsewhere; and furnish his own statement of the duties he performed, time performed, and circumstances surrounding the performance. All the pertinent information should then be sent along with the employee's application for retirement to the manpower division for determination. The Regional Flight Surgeon will also submit a recertification that the employee is permanently disqualified for career controller work."

In this section we note that additional officials participate in the approval/disapproval determination relative to the "certification of creditable service," i.e.:

Chief of the Servicing Payroll Branch;

Air Traffic Division Chief;

Designee of the Manpower Division Chief.

Not only are additional authorities designated, but also the section provides that creditable service may be certified by a former supervisor or by an unsworn self-serving statement by the employee himself relative to his own stewardship.

From this implementing order 3410.11A,it is difficult for us to understand how any knowledgable Air Traffic Control Specialist (Center/Tower) would be denied the benefits provided by Public Law 92-297.

By way of review, this issue with kindred subjects was considered by the House Committee on Post Office and Civil Service in the 96th Congress and reported favorably (House Report 96-726 (Part I)) after exhaustive, in-depth hearings conducted by Chairperson Schroeder, Subcommittee on the Civil Service (Serial 96-37).

The Bill was subsequently referred to the House Appropriations Committee which reported the Bill adversely (House Report 96-726, Part 2) but with an important recommendation quoted as follows:

> "The Committee is cognizant of the potential for detrimental effect on *employee morale* resulting from the exclusion of flight service station specialists from programs such as those authorized by Public Law 92-297. The Committee intends, therefore, to recommend a further review of this problem and its impact on aviation safety. The Committee believes that this further study is necessary before a decision is made with respect to inclusions of flight service station personnel in this program." (Italics added)

On July 24, 1980 - House Appropriations Committee directed further review and report (House Report 96-1193) quoted below:

> "Under Public Law 92-297, air traffic controllers can qualify for an early retirement program, but flight service station specialists are not entitled to similar benefits. In part 2 of the report of H.R. 1262, the Committee recommended a further review of this situation. This Committee reiterates this recommendation and directs the FAA, in cooperation with an independent organization, to report on this matter no later than September 30, 1981."

Finally, on November 24, 1981, the Administrator of the Federal Aviation Administration forwarded his report to the House Committee on Appropriations. In his covering letter the Administrator stated:

> "Based on the findings and conclusions presented by JWK International, we do not find any evidence which warrants the extension of early retirement benefits to Flight Service Station Specialists."

This was an excellent opportunity for the Administrator to express his own views on the issue since the entire Flight Service System is an important part of his organization. He, however, remained silent and relied completely on the views of an outside entity. We can only infer that the FAA Administrator had no position he considered worthy of consideration by the Appropriations Committee.

Believing the JWK International study to be inadequate, the NAATS leadership commissioned the authoritative personnel firm of Ruttenberg, Friedman, Kilgallon and Associates, Inc., to critique the FAA product, which they found to be faulty. These conclusions were forwarded to the House Appropriations

Committee which, subsequently, on August 19, 1982 (Report 97-783), stated:

> "EARLY RETIREMENT - Under Public Law 92-297 air traffic controllers can qualify for an early retirement program, but flight service station specialists are not entitled to similar benefits. In part 2 of House Report 96-726 the Committee recommended a further review of this situation. This study was completed in November, 1981, and an analysis of the study was provided to the Committee earlier this year. Because of the questions raised regarding the validity of the conclusions contained in the study, the Committee is considering requesting a General Accounting Office evaluation of both the study and the subsequent analysis."

The Senate and House conferees, meeting on the Department of Transportation and related agencies appropriations in 1983, considered this issue to be of such importance that it was addressed in the Conference Report:

> "The conferees urge that the study and the analysis relative to eligibility of flight service station specialists for early retirement under Public Law 92-297 be referred to the General Accounting Office for evaluation, analysis and report." (Congressional Record, Volume 128, No. 46, Monday, December 13, 1982, page H 9512)

Eventually, in May, 1983, the FAA Administrator, in compliance with the Congressional mandate, forwarded the two studies to the General Accounting Office.

On March 27, 1984, the United States General Accounting Office report B-214320, "Review of Studies on Early Retirement of Flight Service Station Specialists," the GAO concluded:

> "Our review showed that JWK's study results are inconclusive. The results do not support FAA's conclusion that FSS specialists should not be afforded early retirement . . . ."

When the FAA was questioned by Congressman Ratchford about the GAO Report and the GAO conclusions (Hearings - Subcommittee on Transportation, House Appropriations Committee for Fiscal Year 1985 - Part 6, page 572), FAA witness Weithoner responded:

> "Mr. Ratchford, we believe the (FAA - added) study could have been more thoroughly done, and we agree with and accept some of the GAO criticisms. We also disagree with and do not accept some of their observations.
>
> "We believe their review was limited because they concerned themselves only with two documents: our report and the critical report that had been prepared at the request of the union.
>
> "We believe that their criticism would have been somewhat different if they had the opportunity, or had they taken the opportunity, to review some of the supporting documentation and talked with our people at the *Civil Aviation Medical Institute* and so on." (Italics added)

This response by witness Weithoner was a surprise since, at that time, there was an ongoing study at the Civil Aviation Medical Institute relative to the Miami Flight Service Station. It is entitled:

"PHYSIOLOGICAL RESPONSES TO UNVARYING (STEADY) AND 2-2-1
SHIFTS: MIAMI INTERNATIONAL FLIGHT SERVICE STATION
(FAA-AM-85-2 - dtd February,1985)

By C. E. Melton

Civil Aeromedical Institute
Federal Aviation Administration
Oklahoma City, Oklahoma"

The Civil Aeromedical Institute is the FAA's own medical research activity and Dr. Melton has been involved in, and has conducted, many studies related to stress in the Air Traffic Control environment.

Some excerpts from this report are germane to this hearing:

"In 1974 a stress index was formulated in this laboratory based on excretion levels of the stress indicator hormones (SIH's) in urine (KGS, E, and NE). This index facilitated comparison of stress at various ATC facilities (5,7). Basically, the index consists of the product of resting and working values of each SIH mathematically treated so as to provide a unitary common denominator for each SIH. The SIH's are treated in this way so that each will have equal importance in stress assessment; otherwise, the catecholamines' importance would be overwhelmed by the steroids' importance because of the far greater amount of steroid material in urine compared to catecholamines. The individual indices are designated cst (KGS), ce (E) and cne (NE). The average of the three indices is designated Cs, the composite stress index." (Underlining added)

"When stress indices for all ATC facilities studied are listed (Table XIX), MIA IFSS tops the list as the most stressful (Cs=2.60)."

(MIA IFSS means Miami International Flight Service Station.)

Table XIX follows:

TABLE XIX

Comparison of Various ATC Facilities by Means of a Stress Index

Facility	C_s	C_{st}	C_e	C_{ne}
Miami IFSS ('82)*	2.60	.95	1.03	4.85
O'Hare ATCT ('68)	1.05	1.41	.75	.98
Opa Locka ATCT ('72)	.84	.64	.74	1.15
Atlantic ARTCC ('73)	.82	.76	.34	1.37
Miami ARTCC ('72)	.76	.61	.71	.96
Los Angeles TRACON ('74)	.75	.27	1.10	1.44
Houston ATCT ('70)	.74	1.27	.29	.65
Oakland TRACON ('74)	.72	.23	1.31	.61
Houston ATCT ('71)	.68	.89	.62	.52
Oakland TRACON ('72)	.60	.62	.76	.43
Los Angeles TRACON ('72)	.60	.66	.34	.81
Fort Worth ARTCC ('73)	.34	.22	.58	.20

*NOTE: The C_s for Miami IFSS was subsequently corrected as per the Addendum (pages 29-30) to 1.46.

> "It was thought that perhaps the high level of excretion of NE might be a reflection of the age of the subjects. However, the correlation between NE excretion level and age is not statistically significant ($r=0.29$, $p > 0.30$). Some of the subjects were on medication for control of blood pressure; however, there was no apparent significant correlation between medication usage and NE excretion. Analytical reruns and audits of laboratory procedures have likewise failed to reveal experimental error as the cause of the high values. Further, urine collection procedures were identical to procedures used in other studies. The same personnel performed these analyses by the same methods as in the previous studies."
>
> (Underlining added)
>
> "A diligent search for experimental error has delayed this report beyond the reporting time normally required for studies of this type and the search will continue as long as personnel and facilities are available for this purpose or until the validity of the high values is established.
>
> "The MIA IFSS employees as a group possibly show the highest level of acute workload stress of any ATC facility yet studied."

It is apparent to NAATS that the Miami International Flight Service Station did not fit the mold which we believe was presupposed by the FAA's Civil Aeromedical Institute.

In fairness to Dr. Melton, he did include information as to his checks and double checks of all procedures in the laboratory reruns. In fact, at the end of the report he included an addendum to express his views, not based on fact or research, but based on his belief and conjecture:

> "It is now believed that, by human error, samples for creatinine analysis were taken from the nonacidified moiety, resulting in low creatinine values. Because the weight of creatinine forms the denominator of the creatinine-based ratio, calculated SIH's were inordinately high. The fact that all SIH values were high, impelled us to look first at the creatinine analysis, but the samples for the reruns were again taken from the urine previously set aside for creatinine analysis, thus giving

> the same result as the first run. It was only when we started from "square one" that we realized what had happened."
>
> (Underlining added)

The last sentence in the above paragraph is not understood since throughout the report it is apparent that the CAMI staff and Dr. Melton started from "square one" many times.

Even with his "correction", Dr. Melton states:

> "Because the error is a relatively constant one, we do not believe that conclusions regarding differences in the two shift patterns are compromised. The computed level of stress is changed, however, to about half the value reported."

And, finally, FAA's Dr. Melton states:

> "The Miami International Flight Service Station (MIA IFSS), though, still retains its number one position on the stress index list, surpassing even O'Hare Tower during the high-stress time of the 1968 ATC slowdown (IFSS Cs= 1.46, ORD Cs= 1.05)."

(ORD means O'Hare Tower.)

On February 6, 1985, the Honorable Gene Taylor of Missouri introduced HR 989 in the House of Representatives, which seeks to include Flight Service personnel for early retirement.

On June 27, 1985, The Honorable Mary Rose Oakar, Chairperson, Subcommittee on Compensation and Employee Benefits of the House Post Office and Civil Service Committee, held hearings on HR 989.

In his statement before that Subcommittee, Mr. Taylor stated, among other compelling arguments, the following:

> "The Secretary of Transportation recognized the hazards of the workplace in the Flight Service System, in the implementation of 5 USC 5542 by including station employees for eligibility for special overtime pay and stated:

> '(A) The duties of which are critical to the immediate daily operation of the Air Traffic Control System, directly affect aviation safety, and involve physical or mental strain or hardship.'

In my view, this action alone is sufficient reason for the enactment of H. R. 989.

"General Aviation is the most hazardous segment of aviation, and yet, the FAA denies early retirement benefits to employees involved with general aviation and provides these same benefits to those employees involved with scheduled carriers, the safest segment of aviation.

"If fairness and equity in the work force is to be achieved and if aviation safety is to be enhanced, we have no alternative but to include the air traffic control specialists in stations within the group entitled to early retirement and remove the stigma of separateness from these loyal and dedicated Federal employees."

And that, Mr. Chairman and Members of this Committee, is where the matter stands today.

In our view, the recommendations to aircraft pilots by Air Traffic Control Specialists (Station) are just as important and just as vital to aviation safety as the recommendations by Air Traffic Control Specialists (Center, Tower), including such geographical locations as O'Hare, Kennedy, Los Angeles and any other area.

The issue is one of fairness and equality, and our community of Specialists has been second class citizens since the passage of PL 92-297, and they consider themselves as such.

It is axiomatic that all personnel in the same personnel category must be treated equally and fairly if high morale, good order and discipline are to be achieved. This is not the case in the Air Traffic Control community where there exists a caste system of noblemen and serfs.

We believe it to be appropriate to quote the Chairman of the Subcommittee on Investigations and Oversight of the House Committee on Public Works and Transportation in his hearing record, "The Impact of Weather on Aviation Safety". (98-44, pages 425-26)

> "We did not begin this inquiry with the thought that it might solve the weather problem, but I believe we did put a handle on some of the things which will help in improving our accommodation of weather into the Nation's air transportation system.
>
> "Initially, we learned some alarming statistics from the Safety Board as to the impact of weather on general aviation, commuter airlines, and the air carrier operations. The percentages quoted for the number of fatal accidents where weather was considered a factor seem to be far beyond what the safety investigators had expected to find, and certainly they were shocking to us.
>
> "The loss of even one life is difficult to accept, but the 5-year total of 4,000 tells us that a lot of people may be concerned about weather. But not enough people are talking about how to avoid flying into these turbulent cells.
>
> "We heard of the planning activities of some carriers who utilize all the weather information available so as to avoid flying near or into what may be a hazardous situation. But we also heard of some of the difficulties associated with general aviation attempts to obtain weather information from flight service stations.
>
> *"It became pretty clear that the message being given by all the witnesses is that suspect weather cells should be avoided just as one aircraft should avoid the path of another aircraft."* (Italics added)

We urge that Air Traffic Control Specialists (Station) - Flight Service Personnel - be provided the same early retirement opportunities as are accorded to other Air Traffic Control Specialists of the same Series 2152 designation.

Thank you, Mr. Chairman

U.S. Department of Transportation

1 1985

News:

Office of the Assistant Secretary for Public Affairs
Washington, D.C. 20590

FOR RELEASE TUESDAY
March 5, 1985

FAA 10-85
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FAA REPORTS MORE THAN 1,000 FLIGHT ASSISTS IN 1984

In April 1984, a Federal Aviation Administration air traffic controller in St. Louis gave flying instructions by radio to a woman in a private aircraft when her pilot-husband suffered a heart attack. The controller guided her down to a safe landing.

A few months later, Miami controllers, confronted with the same scenario, provided similar assistance and went home that night knowing they had saved a human life. And in November, Kansas City controllers helped two passengers keep their airplane straight and level until the ill pilot recovered consciousness and brought them all down safely.

The FAA calls these incidents flight assists, and during 1984 controllers and flight service station specialists were involved in 1,069 assists, possibly saving the lives of 2,852 people.

Secretary of Transportation Elizabeth Hanford Dole said, "I am very proud of the highly professional work done by the air traffic control specialists who have guided so many pilots in distress to safe landings. They bring credit to the entire air traffic control service."

FAA Administrator Donald D. Engen said that these flight assists happened at a rate of roughly three a day in 1984, and that almost all of them involved private and business aircraft.

More typically, the assistance given to pilots in trouble involves less dramatic situations, although most assists are still critical. Typically, a non-instrument rated pilot is lost, caught on top of clouds and may be running low on fuel. Controllers and flight service station specialists use radar or direction-finding equipment to pinpoint the pilot's position, talk him down through the overcast, and guide him to the closest airport for a safe landing.

The FAA Administrator said, "These flight assists rarely make the newspapers or evening television news, so the outstanding work done by the agency's air traffic control specialists on a day-to-day basis goes largely unnoticed by the general public.

"However," he added, "I believe the aviation community understands and appreciates these efforts, and pilots fly with a lot more assurance knowing that help from the FAA is as close as their radio microphone if they should get in trouble. Both the pilots and controllers know that the FAA is here to serve."

# # # # #

NATIONAL GUARD ASSOCIATION OF THE UNITED STATES
ONE MASSACHUSETTS AVENUE, NORTHWEST • WASHINGTON, D.C., 20001 • (202) 789-0031

STATEMENT BY
LIEUTENANT GENERAL LA VERN E. WEBER (RET.)
EXECUTIVE DIRECTOR

of the

NATIONAL GUARD ASSOCIATION OF THE UNITED STATES

to the

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

10 September 1985

TESTIMONY BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
10 September 1985

Mr. Chairman and members of the committee, I appreciate this opportunity to appear before you today to present the views of the National Guard Association of the United States on the provisions of the Civil Service Pension Reform Act, S.1527.

The Association supports the overall design of the proposed retirement plan, which utilizes a three-tier system of Social Security, a defined benefit plan and a thrift savings plan. We are especially appreciative of the concern shown by this committee for the nearly 47,000 military technicians who, by law must maintain military membership in the Army and Air National Guard as a condition of their federal Civil Service employment, and are subject to mobilization and deployment in their military status.

While we generally support the bill, the Association does have several concerns relating to specific provisions applicable to military technicians.

In passing the National Guard Technicians Act of 1968, Congress anticipated that the eligibility requirements of age 55 with 30 years service for an unreduced annuity would blend well with a technician's military career. This assumption has been proven correct. We fully support continuation of this criteria, and appreciate the committee's inclusion of such a provision in the new retirement plan.

In 1968, Congress also recognized that the military retention laws would make the discontinued service retirement provisions, at age 50 with 20 years service or at any age with 25 years service, a key factor in the technician program. For example, military separations often occur between the ages of 53 to 55, due to the retention provisions of the Reserve Officer Personnel Act. Even though such individuals take a two percent reduction in annuity for every year under age 55, this concept has caused relatively few problems and has proven to be harmonious with the technician's military career.

The National Guard Association believes that the proposed increase in penalty reduction from two percent to five percent for each year under 55 will have a drastic impact on those technicians who, unlike other federal employees, lose their federal Civil Service employment when loss of military membership occurs. Full consideration must be given to the effect of loss of military membership on a technician's Civil Service employment. We urge the committee to reconsider this portion of the bill and continue the two percent provision.

Mr. Chairman, the National Guard Association has one additional important area of concern. You have stated that the proposed legislation is intended to encourage employees to remain for a full career, to maintain the standard of living for a career employee into retirement, and to provide good benefits while restraining costs. We feel the bill establishes an excellent vehicle for accomplishing those goals, through the establishment of the three-tier system. However, the Association is seriously concerned about the possible absence of one of the tiers during an extended period immediately following a military technician's retirement.

The new plan relies on the Social Security tier to provide a substantial portion of the employee's retirement income. The absence of this tier for any period would significantly reduce the retiree's overall annuity and would certainly preclude continuing the employee's previous standard of living into retirement.

The necessity to provide for retirement prior to eligibility for a Social Security annuity has been recognized for special retirement classes, such as law enforcement officers, firefighters, and air traffic controllers. Provisions for revised retirement eligibility criteria and an annuity supplement until age 62 are included in the bill. The annuity supplement equates to the Social Security tier which is not available from the date of retirement until age 62.

The Association urges the committee to consider a change to the bill to provide for an annuity supplement for military technicians similar to that provided for law enforcement officers, firefighters, and air traffic controllers. The bill recognizes the special circumstances of the military nature of the dual-status National Guard technician by providing for a full defined benefit annuity retirement at age 55. We have discussed the need for a two percent penalty provision because of the possible early loss of military membership and the resultant involuntary termination of federal employment. We also feel that the demands for physical ability, coordination and stamina of the military technician are similar to those of the other special retirement classes.

Under the current provisions of the bill, a National Guard technician would be penalized for early retirement mandated by the military relationship of his employment. For example, a technician who is forced to retire at age 53, due to loss of military membership, would not receive a critical portion of his total retirement annuity for approximately nine years.

The Association believes it is the federal government's responsibility to ensure that these dual-status technicians receive fair and reasonable compensation for their years of faithful and dedicated service. We strongly support a change in the bill to provide an annuity supplement from the date of retirement to age 62.

In summary, the National Guard Association of the United States looks forward to offering its support for the proposed new three-tier retirement plan. We solicit the committee's support in revising the plan to decrease to two percent the reduction for those National Guard military technicians who are involuntarily terminated prior to age 55 and to provide an annuity supplement from the date of retirement until age 62.

Mr. Chairman, I wish to thank you for the opportunity to present the views of the National Guard Association. I look forward to working with your staff and members of this committee on this important issue.

Senator EAGLETON. It is now my pleasure to call to the table Dr. Arthur Flemming, one of the truly great men of this country. It is an honor to have you here.

TESTIMONY OF ARTHUR S. FLEMMING, COCHAIR, SAVE OUR SECURITY COALITION

Mr. FLEMMING. It is a privilege to appear before you as we look at issues of common concern. I want to express my appreciation for your leadership in this and many other areas.

Senator EAGLETON. You are going to keep that microphone in? You haven't aged in all the years I have been here. You are just the same as you were. I have aged so my hearing has diminished. So thank you for keeping the mike in.

Mr. FLEMMING. Mr. Chairman, I appear today in behalf of SOS, the Coalition to Protect Social Security. We certainly appreciate the opportunity of testifying on this proposal.

As you know, the SOS is a national coalition of about 100 national organizations with a membership of some 40 million, including the elderly, disabled, and workers. My colleague as cochair is Wilbur Cohen, another former Secretary of Health, Education, and Welfare. He also serves as chairman of our Federal Employee Committee.

As you appreciate, I have a special interest in the issues confronting the committee at this time as a result of my serving as a member of the U.S. Civil Service Commission from 1939 to 1948. Quite a ways back, but we were beginning to look at these same issues back there in those days.

From these two points of view, I want to address what we who are part of the coalition agreed are the chief issues of the legislation. In brief, I would like to talk about the level of benefits for the retired and survivors; the proposal to cut the cost-of-living adjustment and then the rights of the disabled.

As you appreciate, Mr. Chairman, the underlying principle of Social Security is that it is a floor for economic security, and that employers and employees must build on it. It is the united conviction of our coalition that the benefits in the pending bill are not adequate.

Some measure or test to income adequacy should be applied in order to judge the true worth of a retirement plan. Those who drafted this legislation have focused on the amount of benefits in comparison to a person's annual salary at the time of retirement, technically known as the income replacement rate.

To test the adequacy of that replacement rate, we must turn to some baseline. How much does a person need to live on? What is the goal we seek? Is it merely to keep people out of poverty or is it to provide an income which is consistent with our belief that the individual retiree should be able to cope with the hazards and vicissitudes of old age?

Social Security does provide the floor. Of course, there are welfare programs, but surely the goal of the civil service retirement system and, indeed, all retirement plans should be to provide an income which will make it unnecessary for an older person to become a part of our welfare system. Surely the Federal Government functioning in its capacity as an employer needs to provide an adequate living standard for the people who have given so much of their lives to serving the public.

The President's Commission on Pension Policy which reported in 1980 developed what we think is a good standard for retirement income goals. I have included in my testimony a table which uses the final salary of $15,000, $30,000, and $45,000; deals with a retiree at age 62 with 30 years of service, unmarried and without joint survivorship annuity. It shows that the total defined benefit of this proposal at the $15,000 level would be 50 percent; $30,000 level, 45 percent; $45,000 level, 40 percent.

The President's Commission on Pension Policy recommended a replacement rate of 66 percent for the $15,000 category; 58 percent for the $30,000 category; and 54 percent for the $45,000 category. The total defined benefit in this proposal is short. In the case of the low income and average fellow workers, it is so far short of the goal that we believe S. 1527 does not fulfill its basic responsibility for economic security. We believe that the defined benefit plan can and should be strengthened by providing, for example, that employees would earn 1.5, maybe more, up to 1.75 percent, instead of 1 percent of the average of their highest 5 consecutive years of wages for each year of service completed. This would be far more consistent with the practice of progressive private employers than would be the current proposal.

SOS believes that indivduals must bring some personal initiative, such as savings, investments, and insurance to provide for their retirement and their survivors. S. 1527 recognizes this and provides a thrift plan to encourage such participation and a modest term life insurance policy. I will comment on the survivor benefit proposal at a later point.

Regarding the thrift plan, we have reservations. First of all, the generosity of the plan contrasts sharply with austerity of the defined benefit plan. S. 1527 depends far too much on the thrift plan to reach the goal of adequate economic security. The analysis of the Congressional Research Service shows that the drafters of the proposal depend upon the thrift plan for a full 19 percent of the replacement rate. This is the equivalent of around 30 percent of the total retirement income. This, in our judgment, is unrealistic.

According to the Social Security Administration's new beneficiary survey, in a report published in January 1985, very few Americans depend so much on savings for their retirement. Most depend upon their pensions and Social Security and savings represents a small percent of their income, typically less than 15 percent.

A recent poll that the AARP commissioned which was issued just last month found over 80 percent of working Americans agreeing that their income just gets them by and they find it very hard to save for their retirement.

No thrift plan is going to bring about any significant change in that picture.

Moreover, the drafters of the bill seem to think that the higher paid and lower paid will benefit equally from the thrift plan. Common sense tells us this is not so.

I want to note at this point that I was disturbed by the Congressional Research Service analysis of the bill which said that computed benefits were based on uncapped earnings. While I personally share the belief of many that executive pay in the Federal Government is a serious problem and capping it is wrong, I do not think we should make up for that sin by sinning against others. It is wrong to pay a higher replacement rate to the highly paid than the low income and average who need it more. That, however, is the effect of the proposed method for defining benefit computation.

As I understand it, senior executive and political appointees will get thrift matches and benefits computed on salary as high as $86,000, even though it is capped at $68,000. I do not think this is an equitable approach to this problem.

Next, I would like to take a look at the proposed survivors' benefits. The civil service system has always had a poor history of benefits for survivors. There are many elderly widows living on civil service pensions who are below the poverty level or just barely above it. We had thought and hoped that since Social Security provides a foundation for survivors benefits, the civil service plan would build on the foundation in such a manner as to deal more equitably with the problems of survivors than has been the case in the past. But instead of doing this, the proposed plan eliminates to a considerable extent from the civil service plan benefits for young widows with children. Social Security does provide more than what the old system paid, but we must build on that foundation.

The cost of making this kind of a contribution to dealing with the poverty that confronts many in this group would be marginal.

The proposed employer-paid term life insurance is just barely the average of what private sector employers provide.

Also, under this proposal, the civil service benefits of elderly widows would be reduced. In addition, benefits for school-age children have been eliminated. Again, in view of the fact that these cost so little, we do not understand why this has been done.

The Social Security System cannot make up for the loss of all civil service retirement benefits. Social Security is the foundation for economic security. We urge the committee to build on this foundation by restoring the civil service retirement system benefits for survivors. Together, they will make it possible for survivors to come to grips with the hazards and vicissitudes of life. Neither Social Security nor civil service can do it alone.

On the COLA issue, we are unanimously opposed to cutting the cost-of-living adjustment. That would set the wrong kind of precedent. Any defined benefit sets a target at some replacement rate of earned income. We have suggested that the committee adopt the recommended goals of the President's Commission on Pension Policy.

A COLA simply ensures that over the lifetime of the retiree that replacement rate is maintained, that the standard of living does not deteriorate, especially in view of the extraordinary health care costs of the elderly and disabled.

If annual adjustments are not made to allow for the full increase in the cost of living, the whole retirement plan would be invalidated. The full COLA is an integral and essential feature of an adequate retirement program. We urge the committee to return to that principle.

We have reviewed the disability provision from the perspective of our recent experience with the disability program of Social Security.

We oppose the administration of the disability program by multiple contracts with different insurance companies. In our view, it will inevitably lead to disparate treatment.

The bill also is inadequate and inconsistent with Social Security in providing the disabled with adequate protection in connection with the process of medical reevaluation. We urge the committee to incorporate the same standards and the same provisions for due process as are available to Social Security beneficiaries. We are ready to advise the committee on this issue.

We have reviewed S. 1527 from the point of view of pensions available to other workers in America.

As a member of the U.S. Civil Service Commission, I always when I appear before the Congress, urge that the Federal Government, as an employer, should be known as one of the Nation's most progressive employers. I still believe that this should be our standard.

If S. 1527 should be enacted into law, it would not meet this test. We believe that we should be moving toward this standard if the plan incorporated these minimal provisions:

An accrual rate of at least 1.5 to 1.75 percent; a much less coercive penalty for elderly retirement. What is proposed is more severe than the normal and does not allow for the very common conditions of people who are forced to retire. Moreover, to impose any penalty at all for people who are forced to retire, whether because of job requirements or incapacity is inequitable.

Building in some incentives for later retirement, such as augmented benefits for longer careers and a much less generous thrift plan and a stronger defined benefit with improvements especially for survivors.

We urge that the committee give consideration to these recommendations. If SOS can help you in your continued work, please call upon us. Our committee on Federal employees has access to some of the best talent in the country, and we will be very happy to work with you and your staff.

Senator EAGLETON. Thank you, Dr. Flemming. Your chart on page 3, of course, does not include any return from the CAP, the thrift plan. I realize with low-paid Federal employees, there may not be much, if any, invested in the CAP plan.

Mr. FLEMMING. I could argue—I don't know just what you would put in there. You have to speculate.

Senator EAGLETON. An individual, for instance, using your chart, whose final salary was $45,000, chances are, he or she put something in the CAP plan.

Mr. FLEMMING. Yes.

Senator EAGLETON. The individual making $15,000, chances are, probably not. But I admit, it is speculative.

Mr. FLEMMING. That's right.

Senator EAGLETON. Doctor, earlier today we had some—have you been here all day? I hope not.

Mr. FLEMMING. No; I have been over on the House side.

Senator **Eagleton**. Earlier today we had some discussion with some of the witnesses about this level of payment business. Under the Stevens bill, all the individual pays in is 7 percent; that is the 7 percent to Social Security and nothing more under the Stevens bill.

Under the existing retirement system, the individual pays in 8.3 percent—7 to the system and 1.3 to Medicare. We were discussing the wisdom of having so-called level payments; that is, in the new system having the individual pay in another 1.3. We have been discvssing whether we should do that, and if we do, where to place that 1.3 percent. Do we place it in the defined benefit portion, as most of the witnesses have encouraged, or some have encouraged, or do we place it in the thrift plan, automatically putting the person in the thrift plan to the tune of 1.3.

I would like to have SOS give us their views on that. You don't have to give it off the top of your head. You probably want to talk with your colleagues, and we would like to have your view on that in the next week or so, if you could.

Mr. **Flemming**. I will be very happy to do that. It is an interesting idea.

Senator **Eagleton**. I am not quite tracking with you on your statement with respect to the disability benefits. That begins at the bottom of page 7 and goes over a bit to page 8.

Mr. **Flemming**. There, Senator, I should give you and the committee a memorandum on that.

Senator **Eagleton**. Would you?

Mr. **Flemming**. Yes, which spells that out. That is very brief. That is a boildown.

Senator **Eagleton**. Give us an expanded memo on the disability.

Mr. **Flemming**. Because we have, as you know, been working very hard on the disability part of Social Security and SSI. I think we can give you a memorandum which will spell out some of our experiences and then apply it to this bill.

Senator **Eagleton**. That would be excellent. Thank you, Doctor. I will get those two memos from you.

Mr. **Flemming**. Thank you very much for this opportunity.

Senator **Eagleton**. Ms. Marie Argana, national president, Federally Employed Women. Ms. Argana.

TESTIMONY OF MARIE ARGANA, NATIONAL PRESIDENT, FEDERALLY EMPLOYED WOMEN ACCOMPANIED BY CHRIS deVRIES, LEGISLATIVE DIRECTOR

Ms. **Argana**. Thank you, Senator Eagleton. With me is Chris deVries, our legislative director.

Thank you for asking the Federally Employed Women to testify here today. Federally Employed Women [FEW], is an international membership organization representing women in the Federal Government throughout the United States and foreign countries. FEW is a private, nonprofit, nonpartisan organization and was founded in 1968 to advocate equal opportunity and foster full potential for working women in the Federal sector.

Women employed by the Federal Government have a vital interest in the development of a supplemental civil service retirement system. In 1984, there were over 800,000 Federal women workers.

Women comprised nearly half of the total Federal work force. Many of these women are dependent upon their retirement annuity as their main source of income during their retirement years.

Retirement income that women Federal retirees depend upon is usually inadequate to live on comfortably. In 1984, the median monthly annuity for retired Federal women was $740 as compared to $1,081 for men. Women retired from Government receive lower annual annuities than their male counterparts in large part because female Federal workers are concentrated in the lowest paying grade levels. Of all women who work for the Federal Government, 75 percent are in the GS grades 1 through 8.

The median wages for federally employed women in the GS classification system totaled $18,864 per year in 1984. Under the current retirement system, women replace, on the average, 46.5 percent of their final pay as compared to 47.2 percent for men.

When examining the median years of service for Federal employees, however, it is shown that it is similar to men employed by the Federal Government. The median years of service in the civilian work force total 25.2 for women as compared to 26.7 for men. Federal women also tend to retire at a later age than men in order to gain full retirement benefits. Therefore, women's low-retirement annuities can in large part be attributed to their low earnings.

Older women are the fastest growing poverty population in our Nation. Federal women retirees share the same burdens in their retirement years as all other women. The great majority of elderly women live alone, depend on their retirement benefits for the majority of their income, and pay increasing shares of that income for medical bills.

In 1983, 52 percent of elderly white single women and 84 percent of elderly black single women lived at or near the poverty level. Today, working for the Federal Government is no guarantee that a Federal woman retiree will not join the increasing ranks of elderly women living in poverty.

Although the current civil service retirement system is gender neutral, it has a disparate impact upon women. The present system rewards employees with high earnings and lifelong Federal careers with high-retirement annuities. Women who do not occupy high-paying occupations in the Federal Government suffer under the current retirement system. The benefit calculation that averages the 3 years of the highest earnings with an increased percentage of return as the number of years of service increases affords women little opportunity to build a substantial retirement annuity. Although the question of women's concentration in the lowest grade levels and resulting low wages is another concern, it must be taken into account when looking at a retirement system. The new supplemental retirement system cannot ignore these facts and continue to discriminate against federally employed women. FEW urges this committee to closely examine women's current status in the Federal work force when designing this new system.

FEW envisions a new retirement system with either two or three levels. The basic annuity would consist of the Social Security benefit with a defined benefit as the second level and possibly an optional capital accumulation plan as the third level. FEW urges the implementation of a defined benefit plan as the second level benefit, rather than a defined contribution plan, because a defined benefit plan targets a set of retirement annuities under specified conditions. These specific benefits allow workers to better plan for their retirement years. Also, a defined benefit plan eases the addition of supplemental benefits, such as disability and survivor, and can be retroactive for employees hired prior to the enactment of the plan. This latter aspect is important because the Federal workers who will be under the new system are currently entering the work force. Defined contribution plans, on the other hand, are not usually utilized by large corporations, but rather by small companies or for short-service employees. Defined contribution plans are more risky and do not allow workers to plan adequately for their retirement income.

Capital accumulation plans are becoming increasingly more popular among private sector companies. Under a typical 401(k) thrift plan, employees can defer a percentage of their yearly earnings to a retirement account. A range of options exist on employer matchings of this deferred income. Retirement income from a capital accumulation plan is directly related to one's investment participation. Many women would be unable to take advantage of a capital accumulation plan, due to their inability to decrease their modest take-home pay, but such a plan would afford higher paid employees the option of higher retirement benefits with immediate tax savings.

There are certain components of the present civil service retirement system that should be kept intact. FEW believes that the current structure of full benefits at age 55 with 30 years of service should be continued. Many employees have entered the Federal service with the understanding that they can exercise this option. Although women employed by the Federal Government currently retire later than their male counterparts, they should retain the option of retirement at age 55. Also, as we see women's labor force attachment grow stronger and more continuous, it is likely that more women will have enough years of service to retire with full benefits at age 55.

FEW would also like to see the present computation of the 3 years of highest earnings for benefit calculations preserved. Although women have a relatively flat earnings profile as opposed to male workers, women are beginning to make inroads into the higher-paying grade levels. Because this movement is relatively recent, expanding the computation years will only serve to lower women's final annuity.

Averaging lifelong earnings, as in the Social Security System, would drastically lower these women's retirement annuities. To protect retirement benefits from inflation, cost-of-living adjustments, or COLA's, must be paid on an annual basis. If no COLA provision is provided to Federal retirement benefits, the benefits are quickly eroded away and the philosophy of replacing a percentage of a retiree's salary is lost. The median replacement rate for Federal retired women is 46.5 percent, based on the 3 years of highest earnings. Any reduction in this amount is inadequate to live on. For example, after 10 years, with a 4-percent inflation rate, a benefit only has two-thirds of its original purchasing power. A woman retired from the Federal Government must be able to keep her purchasing power in pace with inflation.

Although we contend that certain provisions of the current civil service retirement system should be preserved and implemented into the supplemental system, we will also offer some suggestions on how to change the system to better accommodate Federal women.

As previously mentioned, the current system does not adequately provide women retirees with a decent standard of living. If we base the supplemental system on the present system, women will continue to be losers. At the retirement hearings held in the House Post Office and Civil Service Committee on April 2, 1985, it was stated that Federal employees had to reach the General Schedule grade 9 before they received a Federal annuity as large as the Social Security benefit. Because most women are concentrated in grades below General Schedule 9, they are receiving lower retirement annuities than their private sector counterparts.

Although the Social Security system is not free from inequities for women, the Social Security tilt built into this system guarantees low-wage earners a higher replacement rate of their earnings upon retirement than high-wage earners. Due to the fact that women make up a large part of the low-paid, long-term Federal employees, FEW recommends maintaining the Social Security tilt by simply adding on the supplemental civil service benefit.

The Hay-Huggins Co. has reported that this procedure would be simple to administer. They offer an example of a benefit calculation of 1 percent of base pay for each year of service added to the Social Security benefit. This calculation would fully preserve the tilt incorporated in Social Security benefits. This system is used by several State retirement plans. The Hay group also points out that under this plan, there would be losers and gainers. Short-term, low-paid employees and married employees would gain as compared to the present system, and high-paid career employees would lose relative to the present system. Some of these results could be partially offset by using a benefit calculation that does not give a straight percentage of base pay for each year of service, but rather increases the percentage of base pay as the number of years of service increases, similar to the current system's present benefit calculation.

Using this method would increase the replacement rate for the higher earning, long-term employees. In addition, if a capital accumulation plan was adopted, it is likely that higher earning employees would be more likely to participate and further increase their replacement rate of their final salary.

The Congressional Research Service has provided a model of such a system that includes an add-on supplemental benefit and a capital accumulation plan that allows a maximum 6-percent employee contribution with a 3-percent employer match.

The Social Security tilt is maintained for the lower paid earner, yet the higher paid, long-term employee does not suffer. The President's Commission on Pension Policy reported in 1981 that 51 to 86 percent of before tax final earnings was needed for retirees to maintain a constant standard of living upon retirement in 1980. They also showed that lower earners needed a higher replacement rate of their final salary than higher earners to accomplish a preretirement standard of living. By maintaining the Social Security tilt, part of this goal is accomplished.

By integrating the Social Security benefit with a pension annuity, the long-term, low-paid employee will receive a lower benefit. A 100-percent Social Security offset would eliminate the tilt altogether and continue the philosophy of the present civil service retirement system of penalizing the low earner.

Under the current system, Federal employees contribute 7 percent of their income toward their retirement benefit. Under the Social Security system, employees now contribute 5.7 percent of their income toward the Social Security benefit. FEW suggests that the supplemental retirement system not require an employee contribution beyond the Social Security contribution. According to the GAO, 93 percent of all workers in the private sector do not contribute to their retirement plans. FEW would like to see this practice translate into the supplemental retirement system.

When discussing the question of vesting periods, it is important to note that most Federal employees who leave the Government prior to 10 years of service elect to remove the ir retirement money rather than select a deferred annuity. For this reason, FEW would support either a 5-year or a 10-year vesting period for the supplemental retirement system in order for the system to be compatible with Social Security vesting requirements.

The Hay group has estimated that only 1 percent of employees would receive a benefit under a 5-year vesting period who would not receive benefits under a 10-year vesting period.

The civil service benefits must be protected from fluctuations in the economy, changing political atmospheres, and inflation. Under the current retirement system, Federal agencies match the employee's contribution and the remaining funds come from the Federal Treasury. FEW encourages the committee to set up a system that better segregates the retirement funds from other Treasury funds.

Each agency should be required to set aside funds for this purpose in a similar manner to segregating funds for Social Security benefits. Yearly congressional appropriations to the retirement fund should be eliminated and replaced by a funding formula. It is the ultimate responsibility of the employer to ensure that retirement funds are solvent.

A cost decision must be made whether to approximate benefit levels in the present CSRS or retirement systems in the private sector in comparable companies. We do not feel that the level of benefits afforded Federal employees should be unduly hampered by strict cost constraints. Desired benefit levels should be calculated for cost and adjusted according to funding constraints.

A decision must be made on how to deal with Federal employees hired prior to January 1, 1984. As many of them have devoted the majority of their working lives to civil service under the current civil service retirement system, it is necessary to preserve the current system as it is until all of these employees have retired. FEW would, however, also suggest opening the new retirement system to employees hired prior to 1984, allowing them the option of participating in the new system.

With regards to S. 1527, FEW commends this committee for diligently working toward a fair and equitable retirement system for Federal employees and introducing S. 1527. There are, however, several components in the proposed legislation that will provide inadequate retirement benefits for a large number of women employed by the Federal Government.

As mentioned previously, averaging the 5 years of highest earnings, providing a reduced cost-of-living adjustment, and increasing the retirement age will lower Federal women's retirement annuities due to the low earnings women receive.

Although we support the concept of a thrift plan, many women in the Federal service will not be able to exercise this option and defer a portion of their earnings as they need their income to support themselves and their families. We look forward to working with this committee on developing a retirement system that provides equitable retirement annuities to women employed by the Federal Government.

The supplemental civil service retirement system should maintain the integrity of a Federal retirement system and provide adequate benefits to employees of all income levels while attracting a qualified Federal work force and not penalizing low earners. This task is no small job. In today's atmosphere of constant attacks on Federal workers, it is even more important that a new retirement system be designed that will reward hard-working civil servants and attract talented new employees.

FEW urges this committee to look at the current status of women employed by the Federal Government and to incorporate your findings into a new system that does not penalize low-wage earners.

We would suggest taking civil service womens' employment data and inputing it into a retirement computer model to determine how women will fare under the variety of proposed retirement systems.

Even though there is a wealth of excellent information on supplemental civil service retirement plans, there is little data on how these proposals would impact women retired from the Federal Government. Although women are moving into higher grade positions, the fact that most federally employed women are concentrated in the lowest General Schedule grade levels will not substantially change in the near future. These hard-working, devoted Federal employees cannot be ignored in the development of a new supplemental civil service retirement system.

Thank you for asking federally employed women to testify before the committee today. I will be happy to answer any questions the committee has.

Senator EAGLETON. Thank you very much, Ms. Argana. Your statement is a very constructive one. You are used to this committee.

Let me ask you this question. I think the statistics show that women are in and out of the work force much more than men, isn't that correct?

Ms. ARGANA. Yes, at the moment. Women are becoming more attached to the work force, but that is true for prior data.

Senator Eagleton. So for those women who are going to work for a period of time and for whatever reason might not work for a period of time and once again work for a period of time—contrasting the old system, the one in place, with the new one beinq designed as proposed by Senator Stevens—there is some advantage in the structure of the new system, is there not?

Ms. Argana. Yes, there appears to be.

Senator Eagleton. If we increase some of the numbers in the Stevens bill, and this is very speculative because I can't tell you precisely what they might be increased to, but if the benefits, some of the ones that you described, if the COLA were increased to a level more attractive than exists in the Stevens bill, if early retirement were improved a bit beyond the Stevens bill, if the accrual rate were improved perhaps a bit, disability improved a bit, a general enhancement of the Stevens package, would you estimate that a sizable number of women workers would opt to transfer from the old system to the new system?

Ms. Argana. That's a very difficult question to answer.

Senator Eagleton. My guess—I am not an expert——

Ms. deVries [interposing]. I think if a lot of women employed by the Federal Government were made aware if this and the Stevens/Roth proposal was enhanced, they would probably get a larger benefit than under Social Security: that is a very convincing argument.

The Stevens/Roth proposal certainly provides more mobility for women in the current system. Federal women workers tend to be more attached to the workforce than the average women in the private sector. Of course, the economic needs of families and single mothers are increasing.

I think the Stevens/Roth proposal certainly could be worked with. One of our main problems with it is that the benefit levels are largely dependent upon the thrift plan, and under the current statistics, most women employed by the Federal Government today could not take advantage of that thrift plan.

Senator Eagleton. That leads me to the next question. This 1.3 question, were you here when I was posing that question?

Ms. deVries. Yes.

Senator Eagleton. Do you have a view on that? Part A, should we impose the additional 1.3? That is the question. Senator Stevens has it tailored down to 7. Should we impose another 1.3, and, part B, where should we put it?

Ms. deVries. We have no objection to the 1.3-percent contribution. We would like to see it put into the defined benefit part of the plan.

Senator Eagleton. Why is that?

Ms. deVries. Just because that part of the plan will benefit women more. It is a guaranteed benefit they will receive on which they will be largely dependent.

Senator Eagleton. Did you hear the statistics I got from GAO?

Ms. deVries. I wasn't here.

Senator Eagleton. GAO tells us that if we put the 1.3 in the thrift package, it could ultimately enhance benefits by as much as 12 percent, and if we put it in the defined benefit part, it will only enhance benefits by as much as 3 percent. We are going to try to draw that out a bit more. That is what they tell us.

If that is the case, then it would seem to be a very clear bargain to go thrift vis-a-vis go defined benefit. If we draw that out, we may circulate it to all the various witnesses and ask them to comment. It is intriguing to me.

Could you elaborate a bit, on page 9 of your testimony, the paragraph entitled "Costs." Could you elaborate a bit? What point are you making there?

Ms. DEVRIES. This point was made in regard to when OPM was setting a cost target. They wanted to lower the cost of the new system as opposed to the present system by a certain percentage of payroll. Basically, what we are saying is, cost, of course, is a consideration, but it cannot override the consideration of adequate benefits for women retirees.

Senator EAGLETON. I appreciate that point. My only joiner with that is if we are going to get a bill signed, passed in both Houses and signed, the cost of the new system as a percent of payroll is going to have to be less than the old system. Now, query, how much lower and in which category? That is a big query. This would be an exercize in futility if we came in with a plan that cost as much or more than the old system because the man downtown ain't going to sign that.

Ms. ARGANA. We did not suggest that funding constraints should not be considered. It is just that we didn't think they should be primary, first importance.

Senator EAGLETON. Got you. Thank you very much.

[The prepared statement of Ms. Argana follows:]

f.e.w.
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TESTIMONY
OF
FEDERALLY EMPLOYED WOMEN
BEFORE
SENATE GOVERNMENT AFFAIRS COMMITTEE
ON
THE DEVELOPMENT OF A SUPPLEMENTAL CIVIL SERVICE RETIREMENT SYSTEM

SEPTEMBER 10, 1985

SENATOR ROTH, THANK YOU FOR ASKING FEDERALLY EMPLOYED WOMEN TO TESTIFY HERE TODAY. FEDERALLY EMPLOYED WOMEN (FEW) IS AN INTERNATIONAL MEMBERSHIP ORGANIZATION REPRESENTING WOMEN IN THE FEDERAL GOVERNMENT THROUGHOUT THE UNITED STATES AND FOREIGN NATIONS. FEW IS A PRIVATE, NON-PROFIT, NON-PARTISAN ORGANIZATION AND WAS FOUNDED IN 1968 TO ADVOCATE EQUAL OPPORTUNITY AND FOSTER FULL POTENTIAL FOR WORKING WOMEN IN THE FEDERAL SECTOR.

THE DEVELOPMENT OF A NEW CIVIL SERVICE RETIREMENT SYSTEM FOR FEDERAL WORKERS HIRED AFTER 1983 AND UNDER THE SOCIAL SECURITY SYSTEM IS AN ISSUE OF PRIME IMPORTANCE. WE APPLAUD THIS COMMITTEE FOR CONTINUING TO PURSUE THE DEVELOPMENT OF A NEW SUPPLEMENTAL RETIREMENT SYSTEM THAT WILL MEET EVERYONE'S NEEDS.

WOMEN EMPLOYED BY THE FEDERAL GOVERNMENT HAVE A VITAL INTEREST IN THE DEVELOPMENT OF THE SUPPLEMENTAL CIVIL SERVICE RETIREMENT SYSTEM. IN 1984, THERE WERE OVER 800,000 FEDERAL WOMEN WORKERS. WOMEN COMPRISED NEARLY HALF OF THE TOTAL FEDERAL WORKFORCE. MANY OF THESE WOMEN ARE DEPENDENT UPON THEIR RETIREMENT ANNUITY AS THEIR MAIN SOURCE OF INCOME DURING THEIR RETIREMENT YEARS. IN 1980, THIRTY-SIX PERCENT OF ALL SINGLE ELDERLY WOMEN RETIRED FROM THE FEDERAL SERVICE DEPENDED UPON THEIR GOVERNMENT PENSION FOR OVER 50 PERCENT OF THEIR TOTAL INCOME. THE RETIREMENT INCOME THAT WOMEN FEDERAL RETIREES DEPEND UPON IS USUALLY INADEQUATE TO LIVE ON COMFORTABLY. IN 1984, THE MEDIAN MONTHLY ANNUITY FOR RETIRED FEDERAL WOMEN

WAS $740 AS COMPARED TO $1,081 FOR MEN. WOMEN RETIRED FROM THE GOVERNMENT RECEIVE LOWER ANNUAL ANNUITIES THAN THEIR MALE COUNTERPARTS IN LARGE PART BECAUSE FEMALE FEDERAL WORKERS ARE CONCENTRATED IN THE LOWEST PAYING GRADE LEVELS. SEVENTY-FIVE PERCENT OF ALL WOMEN WHO WORK FOR THE FEDERAL GOVERNMENT ARE IN GENERAL SCHEDULE (GS) GRADES ONE THROUGH EIGHT. THE MEDIAN WAGES FOR FEDERALLY EMPLOYED WOMEN IN THE GENERAL SCHEDULE CLASSIFICATION SYSTEM TOTALED $18,864 PER YEAR IN 1984. UNDER THE CURRENT RETIREMENT SYSTEM, WOMEN REPLACE, ON THE AVERAGE, 46.5 PERCENT OF THEIR FINAL PAY AS COMPARED TO 57.2 PERCENT FOR MEN. WHEN EXAMINING THE MEDIAN YEARS OF SERVICE FOR FEDERAL EMPLOYEES, HOWEVER, IT IS SHOWN THAT WOMEN'S COMMITMENT TO THE FEDERAL GOVERNMENT IS SIMILAR TO MEN EMPLOYED BY THE FEDERAL GOVERNMENT. THE MEDIAN YEARS OF SERVICE IN THE CIVILIAN FEDERAL WORKFORCE TOTALS 25.2 FOR WOMEN AS COMPARED TO 26.7 FOR MEN. FEDERAL WOMEN ALSO TEND TO RETIRE AT A LATER AGE THAN MEN IN ORDER TO GAIN FULL RETIREMENT BENEFITS. THEREFORE, WOMEN'S LOW RETIREMENT ANNUITIES CAN IN LARGE PART BE ATTRIBUTED TO THEIR LOW EARNINGS.

OLDER WOMEN ARE THE FASTEST GROWING POVERTY POPULATION IN OUR NATION. FEDERAL WOMEN RETIREES SHARE THE SAME BURDENS IN THEIR RETIREMENT YEARS AS ALL OTHER WOMEN. THE GREAT MAJORITY OF ELDERLY WOMEN LIVE ALONE, DEPEND ON THEIR RETIREMENT BENEFITS FOR THE MAJORITY OF THEIR INCOME, AND PAY INCREASING SHARES OF THAT INCOME FOR MEDICAL BILLS. IN 1983, 52 PERCENT OF ELDERLY WHITE SINGLE WOMEN AND 84 PERCENT OF ELDERLY BLACK SINGLE WOMEN LIVED AT OR NEAR THE POVERTY LEVEL. TODAY, WORKING FOR THE FEDERAL GOVERNMENT IS NO GUARANTEE THAT A FEDERAL WOMAN RETIREE WILL NOT JOIN THE INCREASING RANKS OF ELDERLY WOMEN LIVING IN POVERTY. WOMEN WHO DEVOTE THEIR WORKING LIVES TO THE CIVIL SERVICE SYSTEM MUST BE GUARANTEED A DECENT STANDARD

OF LIVING UPON RETIREMENT.

THE PRESENT CIVIL SERVICE RETIREMENT SYSTEM

ALTHOUGH THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM (CSRS) IS GENDER NEUTRAL, IT HAS A DISPARATE IMPACT UPON WOMEN. THE PRESENT SYSTEM REWARDS EMPLOYEES WITH HIGH EARNINGS AND LIFE-LONG FEDERAL CAREERS WITH HIGH RETIREMENT ANNUITIES. WOMEN WHO DO NOT OCCUPY HIGH PAYING OCCUPATIONS IN THE FEDERAL GOVERNMENT SUFFER UNDER THE CURRENT RETIREMENT SYSTEM. THE BENEFIT CALCULATION THAT AVERAGES THE THREE YEARS OF HIGHEST EARNINGS WITH AN INCREASED PERCENTAGE OF RETURN AS THE NUMBER OF YEARS OF SERVICE INCREASES AFFORDS WOMEN LITTLE OPPORTUNITY TO BUILD A SUBSTANTIAL RETIREMENT ANNUITY. ALTHOUGH THE QUESTION OF WOMEN'S CONCENTRATION IN THE LOWEST GRADE LEVELS AND RESULTING LOW WAGES IS ANOTHER CONCERN, IT MUST BE TAKEN INTO ACCOUNT WHEN LOOKING AT A RETIREMENT SYSTEM. THE NEW SUPPLEMENTAL RETIREMENT SYSTEM CAN NOT IGNORE THESE FACTS AND CONTINUE TO DISCRIMINATE AGAINST FEDERALLY EMPLOYED WOMEN. FEW URGES THIS COMMITTEE TO CLOSELY EXAMINE WOMEN'S CURRENT STATUS IN THE FEDERAL WORKFORCE WHEN DESIGNING THIS NEW SYSTEM.

BASIC STRUCTURE OF A NEW SUPPLEMENTAL CIVIL SERVICE RETIREMENT SYSTEM

FEW ENVISIONS A NEW RETIRMENT SYSTEM WITH EITHER TWO OR THREE LEVELS. THE BASIC ANNUITY WOULD CONSIST OF THE SOCIAL SECURITY BENEFIT WITH A DEFINED BENEFIT AS THE SECOND LEVEL AND POSSIBLY AN OPTIONAL CAPITAL ACCUMULATION PLAN AS THE THIRD LEVEL. FEW URGES THE IMPLEMENTATION OF A DEFINED BENEFIT PLAN AS THE SECOND LEVEL BENEFIT, RATHER THAN A DEFINED CONTRIBUTION PLAN, BECAUSE A DEFINED BENEFIT PLAN TARGETS A SET OF RETIREMENT ANNUITIES UNDER SPECIFIED CONDITIONS. THESE SPECIFIC BENEFITS

ALLOW WORKERS TO BETTER PLAN FOR THEIR RETIREMENT YEARS. ALSO, A DEFINED BENEFIT PLAN EASES THE ADDITION OF SUPPLEMENTAL BENEFITS (I.E. DISABILITY AND SURVIVOR) AND CAN BE RETROACTIVE FOR EMPLOYEES HIRED PRIOR TO THE ENACTMENT OF THE PLAN. THIS LATTER ASPECT IS IMPORTANT BECAUSE THE FEDERAL WORKERS WHO WILL BE UNDER THE NEW SYSTEM ARE CURRENTLY ENTERING THE WORKFORCE. DEFINED CONTRIBUTION PLANS, ON THE OTHER HAND, ARE NOT USUALLY UTILIZED BY LARGE CORPORATIONS, BUT RATHER BY SMALL COMPANIES OR FOR SHORT SERVICE EMPLOYEES. DEFINED CONTRIBUTION PLANS ARE MORE RISKY AND DO NOT ALLOW WORKERS TO PLAN ADEQUATELY FOR THEIR RETIREMENT INCOME.

CAPITAL ACCUMULATION PLANS ARE BECOMING INCREASINGLY MORE POPULAR' AMONG PRIVATE SECTOR COMPANIES. UNDER A TYPICAL 401 (k) THRIFT PLAN, EMPLOYEES CAN DEFER A PERCENTAGE OF THEIR YEARLY EARNINGS TO A RETIREMENT ACCOUNT. A RANGE OF OPTIONS EXIST ON EMPLOYER MATCHINGS OF THIS DEFERRED INCOME. RETIREMENT INCOME FROM A CAPITAL ACCUMULATION PLAN IS DIRECTLY RELATED TO ONE'S INVESTMENT PARTICIPATION. MANY WOMEN WOULD BE UNABLE TO TAKE ADVANTAGE OF A CAPITAL ACCUMULATION PLAN, DUE TO THEIR INABILITY TO DECREASE THEIR MODEST TAKE-HOME PAY, BUT SUCH A PLAN WOULD AFFORD HIGHER PAID EMPLOYEES THE OPTION OF HIGHER RETIREMENT BENEFITS WITH IMMEDIATE TAX SAVINGS.

THERE ARE CERTAIN COMPONENTS OF THE PRESENT CIVIL SERVICE RETIREMENT SYSTEM THAT SHOULD BE KEPT INTACT. FEW BELIEVES THAT THE CURRENT STRUCTURE OF FULL BENEFITS AT AGE 55 WITH 30 YEARS OF SERVICE SHOULD BE CONTINUED. MANY EMPLOYEES HAVE ENTERED THE FEDERAL SERVICE WITH THE UNDERSTANDING THAT THEY CAN EXERCISE THIS OPTION. ALTHOUGH WOMEN EMPLOYED BY THE FEDERAL GOVERNMENT CURRENTLY RETIRE LATER THAN THEIR MALE COUNTERPARTS, THEY SHOULD RETAIN THE OPTION OF RETIREMENT AT AGE 55. ALSO, AS WE SEE WOMEN'S LABOR FORCE ATTACHMENT GROW STRONGER AND MORE CONTINUOUS, IT IS LIKELY THAT MORE WOMEN WILL HAVE ENOUGH YEARS OF SERVICE TO RETIRE WITH FULL BENEFITS AT AGE 55. FEW WOULD ALSO LIKE TO SEE THE PRESENT COMPUTATION OF THE THREE YEARS OF HIGHEST EARNINGS FOR BENEFIT CALCULATIONS. PRESERVED. ALTHOUGH WOMEN HAVE A RELATIVELY FLAT EARNINGS PROFILE AS OPPOSED TO MALE WORKERS, WOMEN ARE BEGINNING TO MAKE INROADS INTO THE HIGHER PAYING GRADE LEVELS. BECAUSE THIS MOVEMENT IS RELATIVELY RECENT, EXPANDING THE COMPUTATION YEARS WILL ONLY SERVE TO LOWER WOMEN'S FINAL ANNUITY. AVERAGING LIFE LONG EARNINGS, AS IN THE SOCIAL SECURITY SYSTEM, WOULD DRASTICALLY LOWER THESE WOMEN'S RETIREMENT ANNUITIES. TO PROTECT RETIREMENT BENEFITS FROM INFLATION, COST OF LIVING ADJUSTMENTS (COLAS) MUST BE PAID ON AN ANNUAL BASIS. IF NO COLA PROVISION IS PROVIDED TO FEDERAL RETIREMENT BENEFITS, THE BENEFITS ARE QUICKLY ERODED AWAY AND THE PHILOSOPHY OF REPLACING A PERCENTAGE OF A RETIREE'S SALARY IS LOST. THE MEDIAN REPLACEMENT RATE FOR FEDERAL RETIRED WOMEN IS 46.5 PERCENT (BASED ON THE THREE YEARS OF HIGHEST EARNINGS). ANY REDUCTION IN THIS AMOUNT IS INADEQUATE TO LIVE ON. FOR EXAMPLE, AFTER 10 YEARS, WITH A 4 PERCENT INFLATION RAGE, A BENEFIT ONLY HAS TWO-THIRDS OF ITS ORIGINAL PURCHASING POWER. A WOMAN RETIRED FROM THE FEDERAL GOVERNMENT MUST BE ABLE TO KEEP HER PURCHASING POWER IN PACE WITH INFLATION.

ALTHOUGH WE CONTEND THAT CERTAIN PROVISIONS OF THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM SHOULD BE PRESERVED AND IMPLEMENTED INTO THE SUPPLEMENTAL SYSTEM, WE WILL ALSO OFFER SOME SUGGESTIONS ON HOW TO CHANGE

THE SYSTEM TO BETTER ACCOMMODATE FEDERAL WOMEN. AS PREVIOUSLY MENTIONED, THE PRESENT SYSTEM DOES NOT ADEQUATELY PROVIDE WOMEN RETIREES WITH A DECENT STANDARD OF LIVING. IF WE BASE THE SUPPLEMENTAL SYSTEM ON THE PRESENT CSRS, WOMEN WILL CONTINUE TO BE LOSERS. AT THE RETIREMENT HEARINGS HELD IN THE HOUSE POST OFFICE AND CIVIL SERVICE COMMITTEE ON APRIL 2, 1985, IT WAS STATED THAT FEDERAL EMPLOYEES HAD TO REACH THE GENERAL SCHEDULE GRADE NINE BEFORE THEY RECEIVED A FEDERAL ANNUITY AS LARGE AS THE SOCIAL SECURITY BENEFIT. BECAUSE MOST WOMEN ARE CONCENTRATED IN GRADES BELOW GENERAL SCHEDULE NINE, THEY ARE RECEIVING LOWER RETIREMENT ANNUITIES THAN THEIR PRIVATE SECTOR COUNTERPARTS.

SOCIAL SECURITY TILT

ALTHOUGH THE SOCIAL SECURITY SYSTEM IS NOT FREE FROM INEQUITIES FOR WOMEN, THE SOCIAL SECURITY TILT BUILT INTO THIS SYSTEM GUARANTEES LOW WAGE EARNERS A HIGHER REPLACEMENT RATE OF THIER EARNINGS UPON RETIREMENT THAN HIGH WAGE EARNERS. DUE TO THE FACT THAT WOMEN MAKE UP A LARGE PART OF THE LOW PAID LONG TERM FEDERAL EMPLOYEES, FEW RECOMMENDS MAINTAINING THE SOCIAL SECURITY TILT BY SIMPLY ADDING ON THE SUPPLEMENTAL CIVIL SERVICE BENEFIT. THE HAY-HUGGINS COMPANY HAS REPORTED THAT THIS PROCEDURE WOULD BE SIMPLE TO ADMINISTER. THEY OFFER AN EXAMPLE OF A BENEFIT CALCULATION OF 1 PERCENT OF BASE PAY FOR EACH YEAR OF SERVICED ADDED TO THE SOCIAL SECURITY BENEFIT. THIS CALCULATION WOULD FULLY PRESERVE THE TILT INCORPORATED IN SOCIAL SECURITY BENEFITS. THIS SYSTEM IS USED BY SEVERAL STATE RETIREMENT PLANS. THE HAY GROUP ALSO POINTS OUT THAT UNDER THIS PLAN THERE WOULD BE LOSERS AND GAINERS. SHORT TERM, LOW-PAID EMPLOYEES AND MARRIED EMPLOYEES WOULD GAIN AS COMPARED TO THE PRESENT SYSTEM AND

HIGH-PAID CAREER EMPLOYEES WOULD LOSE RELATIVE TO THE PRESENT SYSTEM. SOME OF THESE RESULTS COULD BE PARTIALLY OFFSET BY USING A BENEFIT CALCULATION THAT DOES NOT GIVE A STRAIGHT PERCENTAGE OF BASE PAY FOR EACH YEAR OF SERVICE, BUT RATHER INCREASES THE PERCENTAGE OF BASE PAY AS THE NUMBER OF YEARS OF SERVICE INCREASES (SIMILAR TO THE CURRENT SYSTEM'S PRESENT BENEFIT CALCULATION). USING THIS METHOD WOULD INCREASE THE REPLACEMENT RATE FOR THE HIGHER-EARNING LONG TERM EMPLOYEES. IN ADDITION, IF A CAPITAL ACCUMULATION PLAN WAS ADOPTED, IT IS LIKELY THAT HIGHER-EARNING EMPLOYEES WOULD BE MORE LIKELY TO PARTICIPATE AND FURTHER INCREASE THEIR REPLACEMENT RATE OF THEIR FINAL SALARY. THE CONGRESSIONAL RESEARCH SERVICE HAS PROVIDED A MODEL OF SUCH A SYSTEM THAT INCLUDES AN ADD-ON SUPPLEMENTAL BENEFIT AND A CAPITAL ACCUMULATION PLAN THAT ALLOWS A MAXIMUM 6 PERCENT EMPLOYEE CONTRIBUTION WITH A 3 PERCENT EMPLOYER MATCH. THE SOCIAL SECURITY TILT IS MAINTAINED FOR THE LOWER PAID EARNER, YET THE HIGHER PAID LONG TERM EMPLOYEE DOES NOT SUFFER. THE PRESIDENT'S COMMISSION ON PENSION POLICY REPORTED IN 1981 THAT 51 TO 86 PERCENT OF BEFORE TAX FINAL EARNINGS WAS NEEDED FOR RETIREES TO MAINTAIN A CONSTANT STANDARD OF LIVING UPON RETIREMENT IN 1980. THEY ALSO SHOWED THAT LOWER-EARNERS NEEDED A HIGHER REPLACEMENT RATE OF THEIR FINAL SALARY THAN HIGHER-EARNERS TO ACCOMPLISH A PRE-RETIREMENT STANDARD OF LIVING. BY MAINTAINING THE SOCIAL SECURITY TILT, PART OF THIS GOAL IS ACCOMPLISHED.

BY INTEGRATING THE SOCIAL SECURITY BENEFIT WITH A PENSION ANNUITY, THE LONG TERM LOW-PAID EMPLOYEE WILL RECEIVE A LOWER BENEFIT. A 100 PERCENT SOCIAL SECURITY OFFSET WOULD ELIMINATE THE TILT ALTOGETHER AND CONTINUE THE PHILOSOPHY OF THE PRESENT CIVIL SERVICE RETIREMENT SYSTEM

OF PENALIZING THE LOW EARNER.

EMPLOYEE CONTRIBUTIONS

UNDER THE CURRENT SYSTEM, FEDERAL EMPLOYEES CONTRIBUTE 7 PERCENT OF THEIR INCOME TOWARD THEIR RETIREMENT BENEFIT. UNDER THE SOCIAL SECURITY SYSTEM, EMPLOYEES NOW CONTRIBUTE 5.7 PERCENT OF THEIR INCOME TOWARD THE SOCIAL SECURITY BENEFIT. FEW SUGGESTS THAT THE SUPPLEMENTAL RETIREMENT SYSTEM NOT REQUIRE AN EMPLOYEE CONTRIBUTION BEYOND THE SOCIAL SECURITY CONTRIBUTION. ACCORDING TO THE GOVERNMENT ACCOUNTING OFFICE (GAO), 93 PERCENT OF ALL WORKERS IN THE PRIVATE SECTOR DO NOT CONTRIBUTE TO THEIR RETIREMENT PLANS. FEW WOULD LIKE TO SEE THIS PRACTICE TRANSLATE INTO THE SUPPLEMENTAL RETIREMENT SYSTEM.

VESTING

WHEN DISCUSSING THE QUESTION OF VESTING PERIODS, IT IS IMPORTANT TO NOTE THAT MOST FEDERAL EMPLOYEES WHO LEAVE THE GOVERNMENT PRIOR TO TEN YEARS OF SERVICE ELECT TO REMOVE THEIR RETIREMENT MONEY RATHER THAN SELECT A DEFERRED ANNUITY. FOR THIS REASON, FEW WOULD SUPPORT EITHER A 5 YEAR OR A 10 YEAR VESTING PERIOD FOR THE SUPPLEMENTAL RETIREMENT SYSYEM IN ORDER FOR THE SYSTEM TO BE COMPATIBLE WITH SOCIAL SECURITY VESTING REQUIREMENTS. THE HAY GROUP HAS ESTIMATED THAT ONLY 1 PERCENT OF EMPLOYEES WOULD RECEIVE A BENEFIT UNDER A 5 YEAR VESTING PERIOD WHO WOULD NOT RECEIVE BENEFITS UNDER A 10 YEAR VESTING PERIOD.

FUNDING

THE CIVIL SERVICE BENEFITS MUST BE PROTECTED FROM FLUCTUATIONS IN THE ECONOMY, CHANGING POLITICAL ATMOSPHERES, AND INFLATION. UNDER THE CURRENT RETIREMENT SYSTEM, FEDERAL AGENCIES MATCH THE EMPLOYEE'S CONTRIBUTION AND THE REMAINING FUNDS COME FROM THE FEDERAL TREASURY. FEW ENCOURAGES THE COMMITTEE TO SET UP A SYSTEM THAT BETTER SEGREGATES THE RETIREMENT FUNDS FROM OTHER TREASURY FUNDS. EACH AGENCY SHOULD BE REQUIRED TO SET ASIDE FUNDS FOR THIS PURPOSE IN A SIMILAR MANNER TO SEGREGATING FUNDS FOR SOCIAL SECURITY BENEFITS. YEARLY CONGRESSIONAL APPROPRIATIONS TO THE RETIREMENT FUND SHOULD BE ELIMINATED AND REPLACED BY A FUNDING FORMULA. IT IS THE ULTIMATE RESPONSIBILITY OF THE EMPLOYER TO ENSURE THAT RETIREMENT FUNDS ARE SOLVENT.

COSTS

A COST DECISION MUST BE MADE WHETHER TO APPROXIMATE BENEFIT LEVELS IN THE PRESENT CSRS OR RETIREMENT SYSTEMS IN THE PRIVATE SECTOR IN COMPARABLE COMPANIES. WE DO NOT FEEL THAT THE LEVEL OF BENEFITS AFFORDED FEDERAL EMPLOYEES SHOULD BE UNDULY HAMPERED BY STRICT COST CONSTRAINTS. DESIRED BENEFIT LEVELS SHOULD BE CALCULATED FOR COST AND ADJUSTED ACCORDING TO FUNDING CONSTRAINTS.

OLD EMPLOYEES

A DECISION MUST BE MADE ON HOW TO DEAL WITH FEDERAL EMPLOYEES HIRED PRIOR TO JANUARY 1, 1984. AS MANY OF THEM HAVE DEVOTED THE MAJORITY OF THEIR WORKING LIVES TO CIVIL SERVICE UNDER THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM IT IS NECESSARY TO PRESERVE THE CURRENT SYSTEM AS IT IS UNTIL ALL OF

THESE EMPLOYEES HAVE RETIRED. FEW WOULD, HOWEVER, ALSO SUGGEST OPENING THE NEW RETIREMENT SYSTEM TO EMPLOYEES HIRED PRIOR TO 1984 ALLOWING THEM THE OPTION OF PARTICIPATING IN THE NEW SYSTEM.

S. 1527

FEW COMMENDS THIS COMMITTEE FOR DILIGENTLY WORKING TOWARD A FAIR AND EQUITABLE RETIREMENT SYSTEM FOR FEDERAL EMPLOYESS AND INTRODUCING S. 1527. THERE ARE, HOWEVER, SEVERAL COMPONENTS IN THE PROPOSED LEGISLATION THAT WILL PROVIDE INADEQUATE RETIREMENT BENEFITS FOR A LARGE NUMBER OF WOMEN EMPLOYED BY THE FEDERAL GOVERNMENT. AS MENTIONED PREVIOUSLY, AVERAGING THE FIVE YEARS OF HIGHEST EARNINGS, PROVIDING A REDUCED COST-OF-LIVING-ADJUSTMENT, AND INCREASING THE RETIREMENT AGE WILL LOWER FEDERAL WOMEN'S RETIREMENT ANNUITIES DUE TO THE LOW EARNINGS WOMEN RECEIVE. ALTHOUGH WE SUPPORT THE CONCEPT OF A THRIFT PLAN, MANY WOMEN IN THE FEDERAL SERVICE WILL NOT BE ABLE TO EXERCISE THIS OPTION AND DEFER A PORTION OF THEIR EARNINGS AS THEY NEED THEIR INCOME TO SUPPORT THEMSELVES AND THEIR FAMILIES. WE LOOK FORWARD TO WORKING WITH THIS COMMITTEE ON DEVELOPING A RETIREMENT SYSTEM THAT PROVIDES EQUITABLE RETIREMENT ANNUITIES TO WOMEN EMPLOYED BY THE FEDERAL GOVERNMENT.

CONCLUSION

THE SUPPLEMENTAL CIVIL SERVICE RETIREMENT SYSTEM SHOULD MAINTAIN THE INTEGRITY OF A FEDERAL RETIREMENT SYSTEM AND PROVIDE ADEQUATE BENEFITS TO EMPLOYEES OF ALL INCOME LEVELS WHILE ATTRACTING A QUALIFIED FEDERAL WORKFORCE AND NOT PENALIZING LOW EARNERS. THIS TASK IS NO SMALL JOB.

IN TODAY'S ATMOSPHERE OF CONSTANT ATTACKS ON FEDERAL WORKERS, IT IS EVEN MORE IMPORTANT THAT A NEW RETIREMENT SYSTEM BE DESIGNED THAT WILL REWARD HARD WORKING CIVIL SERVANTS AND ATTRACT TALENTED NEW EMPLOYEES. FEW URGES THIS COMMITTEE TO LOOK AT THE CURRENT STATUS OF WOMEN EMPLOYED BY THE FEDERAL GOVERNMENT AND TO INCORPORATE YOUR FINDINGS INTO A NEW SYSTEM THAT DOES NOT PENALIZE LOW WAGE EARNERS. WE WOULD SUGGEST TAKING CIVIL SERVICE WOMENS' EMPLOYMENT DATA AND INPUTING IT INTO A RETIREMENT COMPUTER MODEL TO DETERMINE HOW WOMEN WILL FARE UNDER THE VARIETY OF PROPOSED RETIREMENT SYSTEMS. EVEN THOUGH THERE IS A WEALTH OF EXCELLENT INFORMATION ON SUPPLEMENTAL CIVIL SERVICE RETIREMENT PLANS (I.E. GAO, CRS, HAY), THERE IS LITTLE DATA ON HOW THESE PROPOSALS WOULD IMPACT WOMEN RETIRED FROM THE FEDERAL GOVERNMENT. ALTHOUGH WOMEN ARE MOVING INTO HIGHER GRADE POSITIONS, THE FACT THAT MOST FEDERALLY EMPLOYED WOMEN ARE CONCENTRATED IN THE LOWEST GENERAL SCHEDULE GRADE LEVELS WILL NOT SUBSTANTIALLY CHANGE IN THE NEAR FUTURE. THESE HARD WORKING, DEVOTED FEDERAL EMPLOYEES CAN NOT BE IGNORED IN THE DEVELOPMENT OF A NEW SUPPLEMENTAL CIVIL SERVICE RETIREMENT SYSTEM.

THANK YOU FOR ASKING FEDERALLY EMPLOYED WOMEN TO TESTIFY BEFORE THE COMMITTEE TODAY. I WILL BE HAPPY TO ANSWER ANY QUESTIONS THE COMMITTEE HAS.

Senator EAGLETON. We will take a 3-minute break.

[Brief recess.]

Senator EAGLETON. We are once again back in session.

TESTIMONY OF HELENE A. BENSON, SECRETARY OF THE BOARD, CHAIR, RETIREMENT COMMITTEE, PROFESSIONAL MANAGERS ASSOCIATION, ACCOMPANIED BY DONALD E. GILLIS, CHAIRMAN OF THE BOARD, PROFESSIONAL MANAGERS ASSOCIATION

Ms. BENSON. I am Helene Benson. I am accompanied by Don Gillis, the chairman of the Professional Managers Association board of directors.

Senator EAGLETON. Thank you, Ms. Benson. We are delighted to have you here. Proceed.

Ms. BENSON. Thank you.

We appreciate the opportunity to present the views of the Professional Managers Association on S. 1527.

The subject of retirement is of keen interest to our members, Federal midlevel managers, who are greatly concerned about the effectiveness and the efficiency of the Federal Government, and I might add that we have spent more time on this issue than anything else. It is the most important issue to our members, overall retirement.

As you know, our retirement system has come under attack in recent years. Recent studies have shown, though, that the reasons advanced for offering Federal employees less generous benefits than presently provided are invalid. PMA hopes that you can agree with us that simple justice demands that the benefits now promised us by CSRS be delivered. While the Federal Government is not breaking faith with new hires by offering less generous benefits, since new hires have not been promised any specific benefits, PMA sees no reason for offering these employees less generous benefits and feels that doing so will be to the detriment of the Federal Government.

We would first like to summarize our three principal problems with S. 1527.

First, we feel that the plan as proposed favors short-term Federal employees to the detriment of those who spend their careers in the Federal Government. We suggest that the plan be revised to provide a better balancing of the concerns of these two groups. We believe that coverage under Social Security provides the portability sought between the Federal Government and private sector employment. We feel that under the plan as proposed, with such heavy emphasis on the defined contribution portion, the Federal Government will find that it is establishing an expensive severance pay plan, principally benefiting short-term Federal employees, and rather than recruiting the best and the brightest for a career in Federal service, Federal employment will be used and viewed by such individuals primarily as a training program for future private-sector employment.

PMA prefers that the plan to be established be a defined benefit plan and that the contributions of the Federal Government for retirement should go only to the defined benefit plan. If the Federal Government wishes to provide a method of tax-deferred savings in addition, we suggest that it be funded entirely by voluntary employee contributions.

We feel that the defined contribution portion of this proposed plan does not provide the flexibility that it purports to for employees, because those who cannot afford to contribute and do not wish to must forfeit the Federal Government's contribution. In effect, those who do contribute will receive a higher rate of contribution from the Federal Government. PMA feels this is inequitable.

Moreover, the rate of contributions required to receive the maximum contributions from the Federal Government is too high. We also feel that in light of the Reagan administration's proposal to eliminate section 401(k) pension plans, we wonder if the tax deferral of employee contributions would last long after enactment.

Second, PMA is unwilling to forgo for new Federal hires the only two features of Federal employment that are better than the average private-sector employment: That is full cost-of-living adjustments to retirement benefits and the opportunity to retire at age 55 after 30 years of service without reduction of benefits.

In every other aspect of compensation—total compensation, cash compensation, the amount of retirement benefits at age 65, and every other fringe benefit—all the studies have shown that even the average private sector firm does better for its employees than does the Federal Government.

Now, when we say that we are unwilling to forgo age 55 and 30 years of service, we don't mean just retirement at 55 from the defined benefit part of the plan and then you don't get Social Security until age 62. We mean that we would like the plan to bridge the years between retirement and Social Security, as many private-sector plans do. They provide a supplement between age 55 and the time Social Security benefits begin and absorb that cost.

I understand that it would cost you 0.9 percent to do it. I don't know if that figure is accurate or not.

Senator EAGLETON. We will price out that cost. It is an important consideration, and I understand the point you are making.

Ms. BENSON. Right; furthermore, we would like to point out that the Bureau of Labor Statistics study, "Employee Benefits in Medium and Large Firms," found that in 1983, 21 percent of pension plan participants in the private sector were covered by pension plans permitting retirement at age 55 with 30 years of service, or better, with no reduction on account of age.

Our third problem with this plan is that we feel it is modeled too closely on private-sector plans, and the average ones at that, and incorporates features which are problems in the private sector which need correction and should not be imitated by the Federal Government.

To sum up, our position is that the pension plan adopted for Federal employees hired after December 31, 1983, plus Social Security attributable to Federal service, should equal the benefits now provided by the CSRS, and we would like them provided through a defined benefit program. We are not adverse to a thrift plan if it is on top of that, but we suggest that it be funded solely by employee contributions if the Federal Government cannot provide for it on top of that.

One of the things we would like to point out is, on the subject of defined benefit and defined contribution plans, the Reagan administration has come out in favor of the defined benefit plan approach in the private sector. Two former Reagan administration officials, while in the Reagan administration administering ERISA, stated that defined benefit plans offer a far better method of providing retirement income than defined contribution plans.

Robert A.G. Monks, the former Administrator of the U.S. Department of Labor's Office of Pension and Welfare Benefit Programs, said that defined contribution plans, and I quote: "Are simply tax-aided savings plans," and compared defined contribution plans to "massive individual speculation."

Mr. Charles C. Tharp, the former Executive Director of the Pension Benefit Guaranty Corporation, stated that, and I quote: "Defined contribution plans are well-suited to capital accumulation for medium-term objectives." He further stated that defined benefit plans are "distinctly superior" to defined contribution plans.

All of these quotations are in the magazine "Pension and Investment Age," October 29, 1984, which also contains an editorial supporting defined benefit plans and gives the reasons why.

PMA agrees with these reasons. We believe it is unfair to finance the retirement benefits an employee needs to maintain his preretirement standard of living in such a way that the amount of the pension cannot be predicted until retirement and that the amount is subject to market conditions prevailing at the time of retirement.

We believe that defined contribution plans should provide only extras after the preretirement standard of living is maintained through a defined benefit plan. Furthermore, we really believe that you will find that the defined contribution portion of this proposed plan will be more expensive than you anticipated because of the payments made to those who leave before retirement.

On the subject of cost, covering Federal employees under Social Security has an impact. One is that it costs the Federal Government more to provide the same benefits that are provided under CSRS. Some of the contributions of Social Security to be made by the Federal Government as employer will be redistributed from Federal workers to private-sector workers. Now, this cost doesn't translate into a benefit for any Federal workers.

Being covered under Social Security does have its benefits, and one of those is portability. This benefit is a very valued benefit to workers who leave Federal service. But of course, portability is of no value to those who spend their careers in the Federal Government. Those costs translate into a value for those who leave. It does not translate into a benefit for those employees who spend their careers in the Federal Government.

I have a few pages on the CSRS which I am basically going to skip, except to note that CSRS, really, in the past was considered to be comparatively generous to Federal employees compared to private sector employees to make up for our lower salaries, but now it really is inferior to many private-sector retirement systems. This has been borne out by the Hay-Huggins Co. and Hay Management Consultants study for the House.

Senator EAGLETON. Which corporations is it inferior to, pardon that English?

Ms. BENSON. I didn't get the names, but according to the Hay-Huggins study, 10 percent of the companies in their study had plans that cost 25.1 percent of payroll as compared to CSRS' cost at 24.7 percent, which provided better benefits. That is 10 percent of the companies in that study.

One of the points I want to make about cost is that even that cost figure does not include the tax advantage enjoyed by private sector plans, and that tax advantage should be included in the cost. It is not included in the cost of 18 percent or whatever percent you all are using for the cost of average private-sector pension plans. That figure doesn't take the tax subsidy into account, and it really should.

Another point I would like to make is when the Hay-Huggins said the top 10 percent of the companies in their study, their study included the medium and large firms and medium firms included companies with only 100 employees. That is pretty small. We don't think the Federal Government work force is comparable to those work forces.

So I will skip over that part.

PMA thinks that it is unfair to compare only one segment of compensation, retirement, when in every other single element of compenstion—fringe benefits such as life insurance, health insurance and cash compensation—and in total compensation, Federal employees are behind even the employees of the average private-sector firms.

Furthermore, we don't think that the Federal compensation should be compared with the compensation of employees of the average or small private-sector firms, because our workforces are noncomparable.

We are very concerned that Congress is now considering offering new Federal employees lesser benefits than CSRS based on some of the practices of the average private-sector firm.

As noted, some of these practices are problems which need to be corrected, not imitated. ERISA was signed into law 11 years ago, and amendments have been made to it or the Internal Revenue Code every single year since then to correct some of the undesirable aspects of private sector pension plans. Since all of the problems have not yet been corrected, forums and commissions are continually being established and hearings up on the Hill are continually being held to to deal with the remaining problems.

One of those problems is the erosion of retirement benefits through the lack of full COLA's. In the past, bills have been introduced on this problem, and I will bet in a few years, this will be a problem that will be corrected in the private sector.

Anyway, the fact of the matter is that the——

Senator EAGLETON. You are saying that private companies, let's say, the largest in the Nation, will go to a full guaranteed COLA?

Ms. BENSON. Right now, Social Security, of course, is protected from inflation. While not too many of the private-sector firms have a guaranteed full protection against inflation——

Senator EAGLETON. None.

Ms. BENSON [continuing]. Some of them have some guarantees against inflation, and some of them have given increases. But nevertheless, this is still considered a problem in the private-sector. I don't think that they will correct it on their own, but I do think that there will be found a way, however it may be, and there are various ways to do it, that the retirement benefits will be given protection against inflation eventually.

As I say, this is a problem in the private sector. It is not something that should be imitated.

At any rate, the trend over the years in the private sector has been to improve benefits, increase benefits and improve them. With the passage of years, more pension plans have improved their benefit formulas to base benefits on the final gross earnings; more plans have lower retirement ages for unreduced benefits; more plans provide post-retirement increases because of inflation, and in such a climate, we do not think that the Federal Government should be cutting back on Federal employees' benefits. We think it should be improving them.

We don't think the Federal deficit will be improved by reducing our pay package. However, if Federal employees are made, incorrectly, to seem to be overpaid, the public's attention is focused on that misconception, rather on the fact that some individuals and corporations are not required to pay their fair share of taxes and that the American public is subsidizing through taxes some activities which it certainly would not want to if the facts were known and publicized.

We feel a lot has been made of the burden of the Federal taxpayer in paying for Federal employees' pensions. The American taxpayers employ the Federal employee and thus pay our salaries and benefits, but little has been made of the fact that American taxpayers are subsidizing every private-sector employee's pension.

We are subsidizing J. Peter Grace's pension of $357,000 a year, because that is a deductible expense to his company. The American taxpayer is subsidizing lavish business luncheons, entertainment, planes, and yachts, and resort condominiums. The American taxpayers are subsidizing those 40 large profitmaking firms that paid no income tax in 1984. We believe that there is a purpose behind many of these groups and organizations that are concentrating public attention on Federal pensions and other Federal expenditures, and we believe that it is to key public attention on that rather than on the tax structure from which they benefit so lavishly.

We would like to make two points with respect to how the new plan will take into account Social Security benefits earned. Since Social Security replaces a higher proportion of earnings for low wage employees, we don't think it is unreasonable for the tilt to be taken into account. We note that the proposed defined benefit portion of the plan doesn't really. We do prefer an add-on approach, such as you have, because it is easier for employees to understand than an integrated approach. Hardly anybody understands Social Security integration. We feel maybe an add-on approach could be utilized with a higher rate of accrual for salaries over a specified level in order to take the tilt into account.

But regardless of that, one thing that we would like to say is that, however Social Security is taken into account, it is very important that only that part of employee's Social Security benefit attributable to Federal service be taken into account, not the entire, not a specified percentage of the entire Social Security benefit.

Because otherwise, some Federal workers who change jobs who stay in the Federal Government only for a short period of time won't get anything out of the Federal pension plan.

We hope you will keep our concerns in mind when you consider this legislation. PMA earnestly desires that this plan be one which will be instrumental in attracting and retaining an efficient Federal workforce, and we are very happy to assist you in any way in this important endeavor.

Senator EAGLETON. Thank you very much, Ms. Benson.

Do you favor the concept of level payments?

Ms. BENSON. Yes. I mean——

Senator EAGLETON. The 1.3 percent that I keep raising?

Ms. BENSON. That is fine, certainly. Yes.

Senator EAGLETON. So you don't think that——

Ms. BENSON. If it is going to be equal benefit.

Senator EAGLETON. You don't think employees are paying in enough under the Stevens bill? You want them to pay in a bit more?

Ms. BENSON. No. I think they are paying in too much to obtain the maximum Federal contribution.

Senator EAGLETON. Under Stevens' bill, they are paying 7.0.

Ms. BENSON. Plus 5 percent to get the full contribution.

Senator EAGLETON. They are not paying in the 1.3.

Ms. BENSON. Right.

Senator EAGLETON. Are you in favor of them paying in the 1.3 in the defined benefit portion or not paying it in?

Ms. BENSON. We are for a plan that is comparable to this, and we are willing for the employees to contribute comparably to the present levels.

So we would like that 1.3 in the defined benefit plan, if that answers your question.

Senator EAGLETON. You would want, for instance, the accrual rate increased?

Ms. BENSON. Yes, sir. And high 3, not high 5.

Senator EAGLETON. High 3 rather than high 5; and the COLA, the whole bit?

Ms. BENSON. The whole bit.

Senator EAGLETON. We priced out a plan yesterday that did everything like that, and it came out to 28 percent.

Ms. BENSON. CSRS now costs 24.7 percent, and with the addition, with the little additional of the Social Security costs, if you are using the same figures that CRS did, we just don't feel that we should subsidize, that Federal employees should subsidize the cost of their being put under Social Security since you saw fit to put them under Social Security.

We don't feel that they should absorb that cost, although we will grant that portability is a benefit for those who leave.

Senator EAGLETON. If we priced out a plan that was 2 or 3 points below the cost of the present plan, you would rather have no plan at all than to have something priced like that?

Ms. BENSON. No plan at all?

Senator EAGLETON. We would let the new employees pay 14 percent—7 and 7.

Ms. BENSON. That is not really necessary.

Senator EAGLETON. That is what?

Ms. BENSON. We don't feel that that is necessary.

Senator EAGLETON. That is what we face.

Ms. BENSON. Unless you change the deadline.

Senator EAGLETON. Oh? We are faced with a deadline.

Ms. BENSON. You can change the deadline. You are the Congress.

Senator EAGLETON. The most we can change it to is a couple of months. And there is no new plan that the President signs.

Ms. BENSON. We are for a new plan comparable to the present plan.

Senator EAGLETON. What is that?

Ms. BENSON. We are for a comparable new plan. We let you all work out the politics of it.

Senator EAGLETON. They can get a present plan for 14 percent.

Ms. BENSON. I mean a plan equivalent to CSRS.

Senator EAGLETON. We can give them a plan comparable to the existing plan for 14 percent of pay. You don't favor that?

Ms. BENSON. I don't understand. If you spent 14 percent——

Senator EAGLETON. On midnight, December 31, new Federal workers will pay out of their pocket 14 percent of their income, 7 percent into Social Security.

Ms. BENSON. Then I would presume they would get CSRS plus Social Security, for that matter.

Senator EAGLETON. They will get Social Security.

Ms. BENSON. Then they would get both, which we are not proposing. We are not proposing they get both.

Senator EAGLETON. Do you think the workers can handle that?

Ms. BENSON. No, I didn't say that.

Senator EAGLETON. You are not recommending it?

Ms. BENSON. No.

Mr. GILLIS. No.

Senator EAGLETON. Thank you very much.

Ms. BENSON. You are welcome.

[Ms. Benson's prepared statement follows:]

PMA
PROFESSIONAL MANAGERS ASSOCIATION

STATEMENT OF
PROFESSIONAL MANAGERS ASSOCIATION

Before the

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

September 10, 1985

Presented by

Helene A. Benson
Secretary of PMA Board of Directors
and Chair of PMA Retirement Committee

Accompanied by

Donald E. Gillis
Chairman of PMA Board of Directors

P.O. Box 7762 • Ben Franklin Station • Washington, D.C. 20044

Senator Stevens, Chairman, and members of the Senate Committee on Governmental Affairs, thank you for the opportunity to present the views of the Professional Managers Association (PMA) on S.1527, the Civil Service Pension Reform Act, introduced July 30, 1985, to cover post-1983 Federal employees. We would like, first, to thank you Senator Stevens for your pension forums in 1983 and 1984 in which PMA participated. We also appreciate your statement in your letter of December 1982, accompanying the retirement plan you proposed then, that until the majority of those affected by your proposals support it, you would not pursue passage. We urge that you continue to move carefully in this important area.

The subject of retirement is of keen interest to our members, Federal mid-level managers, who are greatly concerned about the effectiveness and efficiency of the Federal government.

As you know, our retirement system has come under attack in recent years. The public and Congress have been bombarded with myths and misconceptions about our retirement system. If there is public indignation over our retirement system, it has been manufactured and its basis is false. Recent studies have shown that the reasons advanced for offering Federal employees lesser benefits than presently provided -- Donald Devine's scare stories about the cost and financial condition of the Civil Service Retirement System (CSRS) and comparisons with private-sector practices -- are invalid. PMA urges that you proceed in the design of a retirement system for new Federal employees on a sound and fair basis, with thoughtful consideration of the ramifications.

Simple justice demands that the benefits promised those now covered by CSRS be delivered. While the Federal government is not breaking faith with new hires by offering lesser benefits since new hires have not been covered under a plan promising any specific benefits, PMA sees no reason for offering these employees lesser benefits and submits that doing so will be to the detriment of the Federal government.

We first briefly summarize our three principal problems and suggestions with respect to the proposed retirement plan and, following that, outline our reasoning in more detail.

First, the plan as proposed favors short-term Federal employees to the detriment of those who spend their careers in the Federal government. We suggest the plan be revised to provide a better balancing of the concerns of these two groups. We believe that coverage under Social Security provides the portability sought between Federal and private-sector employment. Under the plan as proposed, with such heavy emphasis on the defined contribution portion, the Federal government will find that it is establishing an expensive severance plan principally benefiting short-term Federal employees and that, rather than recruiting the best and the brightest for a career in Federal service, Federal employment will be used and viewed by such individuals primarily as a training program for future private-sector employment. PMA prefers that the plan to be established be a defined benefit plan and that the contributions of the Federal government for retirement should go only to the defined benefit plan. If the Federal government wishes to provide a method for tax-deferred savings in addition, we suggest that it be funded entirely by voluntary employee contributions. The defined contribution portion of this proposed plan does not provide the flexibility and range of options for employees that it purports to because those employees who do not wish to contribute to the defined contribution part of the plan and those who cannot afford to must forfeit the Federal government's contribution. In effect, those who can and do contribute to the defined contribution plan will receive a higher rate of contribution from the Federal government than those who do not or cannot contribute. PMA feels that this is inequitable. Moreover, the rate of employee contribution required to receive the maximum contribution from the Federal government is too high. Finally, in light of the Reagan administration's proposal on September 3, 1985, to eliminate Section 401(k) pension plans, we doubt that the tax deferral of employee contributions to the defined contribution portion of the proposed plan would last any length of time after enactment. At any rate, all of us already have the opportunity to save, on a tax-deferred basis, some of our income for retirement by establishing an IRA.

Second, PMA is unwilling to forego for new Federal hires the only two features of Federal employment that are better than the average private-sector employment -- full cost of living adjustments to retirement benefits and the opportunity to retire at age 55 after 30 years of service without reduction of benefits. In every other aspect of compensation -- total compensation, cash compensation, the amount of retirement benefits at age 65, and every other fringe benefit -- even the average private-sector firm does better for its employees than does the Federal government. Further, the BLS (Bureau of Labor Statistics, U.S. Department of Labor) study, Employee Benefits in Medium and Large Firms, 1983, Bulletin 2213, issued in August 1984, found that 21 percent of pension plan participants were covered by pension plans permitting retirement at age 55 and 30 years of service, or lower, with no reduction on account of age.

Third, the proposed plan is modeled too closely on private-sector plans -- and the average or mediocre ones at that -- and incorporates features which are problems in private-sector plans which need correction and should not be imitated by the Federal government.

It is PMA's position that the pension plan adopted for Federal employees hired after December 31, 1983, plus the Social Security benefits attributable to their years of Federal service, should equal the benefits now provided by the CSRS to pre-1984 employees. And PMA recommends that the pension plan adopted for these employees be a defined benefit plan. We welcome an opportunity for employees to save and invest on a tax-deferred basis. However, unless the Federal government can provide and contribute to this opportunity on top of benefits from a defined benefit plan and Social Security which are equivalent to benefits now provided under CSRS, we suggest that, if such a benefit is offered, it be financed solely by voluntary employee contributions.

On the subject of defined benefit and defined contribution plans, we draw the Committee's attention to the fact that the Reagan administration has come out in favor of the defined benefit plan approach -- at least for pension plans in the private-sector. Two former Reagan administration officials, while in the Reagan administration administering the Employee Retirement Income Security Act of 1974, the law regulating private-sector retirement plans, stated that defined benefit plans offer a far better method of providing retirement income than defined contribution plans. Both Robert A. G. Monks, the former administrator of the U. S. Department of Labor's Office of Pension and Welfare Benefit Programs, and Charles C. Tharp, former executive director of the Pension Benefit Guaranty Corporation, while holding those positions in the Reagan administration, have stressed the superiority of defined benefit pension plans. See Pension and Investment Age, October 29, 1984, page 9, for a report of their remarks.

Mr. Monks told attendees at the meeting of the American Society of Pension Actuaries that defined contribution plans "are simply tax-aided savings plans," and compared defined contribution plans to "massive individual speculation." He also stated that defined benefit plans provide the best means of providing benefits to employees.

Mr. Tharp stated to attendees of the Southern Pension Conference and the pension actuaries' meetings that defined benefit and defined contribution plans "have proved best adapted to difference purposes." He stated, "Defined contribution plans are well-suited to capital accumulation for medium term objectives." He further stated that defined benefit plans are "distinctly superior" to defined contribution plans. They encourage orderly retirement from the work force, help limit turnover among those not yet at retirement age, provide past service credit and are more adaptable, and place the burden of investment risk on the employer. "In the coming year in Washington, we may be facing a great debate on the overall shape of our pension system in America," Mr. Tharp said. Limiting the system in favor of savings plans or in the pursuit of short-term revenue gains "will be detrimental to employees, employers and the long term health of our economy," he concluded.

Similar views have been expressed by Senator Jacob Javits, the "father of ERISA."

I would also like to quote, in part, the editorial on page 10 of the October 29, 1984 issue of Pension and Investment Age:

> The Reagan administration finally has come out in support of defined benefit plans, as a story on page 9 of this issue reports. Not that the administration was opposed to defined benefit plans; it simply had been silent on

> whether defined benefit or defined contribution plans were to be favored. Now, Robert A.G. Monks, the Department of Labor's pension administrator, and Charles Tharp, executive director of the Pension Benefit Guaranty Corp., have declared, in separate speeches, that the administration stands behind defined benefit plans as the most efficient way to provide retirement benefits. This could be good news for pension beneficiaries and pension fund sponsors if the administration makes it commitment known to the congressional tax writing committees. The defined benefit plan is the cornerstone of the private pension system. While defined contribution plans have their place, a pension system built only on defined contribution plans would be unstable, at least as defined contribution plans are now designed. A pension system built only on defined contribution plans would be like a house built on sand. The features of the house might be very attractive, but the foundation is porous. . . . Another disadvantage is that the plan participant takes the investment risk in a defined contribution plan. The employer takes the risk in the defined benefit plan. . . .

PMA agrees with these views. We believe it unfair to finance the retirement benefit an employee needs to maintain his pre-retirement standard of living in such a way that the amount of the pension cannot be predicted until retirement and the amount is subject to market conditions prevailing at the time of retirement. PMA believes that a defined contribution plan should provide only extras, not basic economic security. Furthermore, we believe you will find that the defined contribution portion of the proposed plan will be more expensive to the Federal government than anticipated.

Defined contribution plans can be more costly to the employer than defined benefit plans in providing given benefits, as was pointed out at the December 13, 1983 pension forum sponsored by this committee. At that forum the president of Martin E. Segal Company pointed out that, for a given contribution a defined benefit plan can generally provide more in the way of benefits than can a defined contribution plan. Annual pay-outs are higher under a defined contribution plan than under a defined benefit plan because of payments made to those who leave before retirement.

On the subject of cost, covering Federal employees under Social Security has an impact. One is that it will cost the Federal government more to provide the same benefits that are provided under CSRS.

Some of the contributions to Social Security to be made by the Federal government as employer on behalf of Federal employees will be redistributed from Federal workers to private-sector workers. The benefit redistribution to non-Federal employees is caused by Social Security coverage of all types of employment including temporary, part-time, and minimum wage jobs that are not common in the Federal government. This cost to the Federal government for covering Federal employees under Social Security is a cost which does not translate into a benefit for any Federal employees. Since Congress saw fit to put new Federal employees under Social Security, it seems unfair for Congress to bring up now the subject of the cost of that action and expect Federal employees to absorb that cost by receiving lesser benefits.

Being covered under Social Security has its benefits -- for some. Social Security is portable. This benefit is valuable to workers who leave Federal service, but portability is of no value to employees who spend their careers in the Federal government. Thus, this cost does not translate into a benefit for employees who spend their careers in the Federal government.

One of the most widespread misconceptions, even occasionally among Federal employees, is that CSRS is overly generous. On the contrary, generally CSRS provides at most merely adequate, certainly not opulent, benefits. In the past CSRS had been considered comparatively generous to Federal employees as a partial offset to lower salaries of Federal employees when compared with private-sector pensions and salaries. Now the CSRS is inferior to many private-sector retirement systems.

The general consensus is that retirees should be able to maintain the standard of living attained during their working years into their retirement years. In the private-sector, it has been estimated that 50 to 80 percent of the current value of an employee's gross compensation at retirement is needed to enjoy a post-retirement standard of living reasonably comparable to the pre-retirement standard of living. That estimate was based on Social Security benefits not being taxable, the assumption that the retiree's home and furnishings are paid for, the assumption that the retiree is in a lower tax bracket, and the assumption that the retiree has fewer other expenses.

However, experts concede that the actual aggregate reduction in the financial needs of a retired person has been exaggerated and that a much higher percentage is needed. CSRS benefits are totally taxable. An employee who retires from the CSRS after 30 years of service with unreduced benefits will receive only 56.25 percent of the three highest years' average salary. That translates to about 53 percent of final gross salary. The 56.25 percent is reduced for those who provide their spouse with a survivor annuity, as most do, generally to 51 percent, and that 51 percent translates to less that 50 percent of final gross salary. Thus, CSRS presently does not meet even this erroneously low standard for an employee retiring after 30 years with unreduced benefits (except for the reduction for survivor benefit for the spouse).

The maximum pension benefit that can be earned by a civil service employee is 80 percent of the average of the 3 highest years of salary and that requires 41 years and 10 months of service. On the other hand, it is not uncommon for employees in the private sector to receive much higher benefits. This is borne out by a provision of the Employee Retirement Income Security Act of 1974 (ERISA), which regulates private-sector pension plans. ERISA prohibits private-sector defined benefit qualified pension plans from providing benefits higher than the lesser of (1) $90,000, adjusted for inflation, or (2) 100 percent of the participant's average compensation for the highest 3 consecutive years. These limits are based on benefits attributable only to employer contributions. Benefits can be higher than these limits based in part on employee contributions or when provided outside the qualified plan through excess benefit pension plans and other types of non-qualified plans, financed generally by the employer.

The CSRS is merely comparable to or, in some cases, inferior to the combination of benefits provided through the pension plans of the more progressive companies in the private sector and Social Security. And, when you consider additional benefits provided by many private-sector companies, such as stock, profit-sharing, savings and thrift plans, excess benefit plans, etc., there is an even greater disparity. And, let's not forget, these benefits are based on larger salaries -- witness the large number of political appointees, many young and in the early years of their careers, who leave the Federal service after brief appointments because they claim they can no longer live on such low pay. And most of them are paid at the executive-schedule rate, which is higher pay than almost all Federal civil servants receive.

The above statements have been confirmed by the study prepared by Hay/Huggins Company and Hay Management Consultants for the House Committee on Post Office and Civil Service, entitled Study of Total Compensation in the Federal, State and Private Sectors, December 4, 1984. That study showed that in total compensation (the total of cash compensation and fringe benefits) the Federal employee is 7.2 percent behind the private-sector employee on average and that it was expected that the 1985 update of the analysis will show the advantage of private-sector total compensation as 9 percent or more on average. Since that study included small companies, the differences would be even greater if only the large, progressive private-sector employers with work forces similar to that of the Federal government were studied. The study also showed that for employees at the $30,000 pay level the CSRS is 3 percent less valuable that the benefits provided by any of the top 10 percent of private-sector employers in the study.

The study showed that the retirement benefits provided to employees of those top private-sector employers in the study cost the employers 25.1 percent of pay. If the Federal tax subsidy enjoyed by private-sector pension plans were taken into account, as it should be, that cost figure would be higher. The Congressional Research Service estimates the employer cost of the CSRS as 24.7 percent of pay. So, even without taking into consideration the tax subsidy enjoyed by private-sector plans, the cost, 25.1 percent of pay, of retirement benefits provided employees of the top employers in the study exceeds the cost to the Government of the CSRS. The study did find that the overall CSRS benefits are more valuable than private-sector retirement on average, although even the average private-sector pension plan provides better benefits at age 65 than CSRS (an 18 percent higher replacement rate of pre-retirement wages). It also found that the cash compensation and the other fringe benefits of private-sector employees were better on average than that of Federal employees -- and that the total compensation of Federal employees lags the private sector. As stated earlier, the study included small companies (employing as few as 100 employees) whose work forces are not comparable to the highly educated Federal work force, consisting in such large part of professional, technical, and administrative employees who are experts in many diverse fields -- managers, attorneys, employee benefit plan specialists, actuaries, accountants, scientists, program analysts, economists, etc.

PMA submits that it is unfair and intellectually dishonest to compare only one segment of compensation (retirement) when in every single one of the other segments of compensation (fringe benefits such as health insurance and life insurance and cash compensation) and in total compensation Federal employees are behind even the employees of the average private-sector firms. Moreover, it is unfair to compare Federal compensation with the compensation of the employees of the average or small private-sector firm when the Federal government's work force is so unlike such work forces.

PMA is very concerned that Congress now is considering offering to new Federal employees lesser benefits than CSRS provides based on some of the practices of the average private-sector pension plan. As noted earlier, some of these practices are problems which need to be corrected, not emulated by the Federal government as employer. ERISA was signed into law 11 years ago and amendments have been made to it or the Internal Revenue Code every year since then to correct some of the undesirable aspects of private-sector plans. Since all of the problems have not yet been corrected, forums and commissions have been established and congressional hearings held to deal with the remaining problems. For example, while Social Security benefits are protected from inflation by the COLA's and while many private-sector employers have increased retirees' benefits because of inflation, one of the problems of many private-sector plans is the erosion of the retirement benefit over the years due to inflation. In fact, over the years, bills have been proposed in Congress regarding this problem and it will probably not be long before it is corrected.

Moreover, the fact of the matter is that the trend in employee benefits in the private-sector over the years has been to increase and improve employee benefits. Thus, with the passage of years more and more pension plans have improved their benefit formulas to base benefits on final gross earnings; more plans have lower retirement age for unreduced benefits; more plans provide post-retirement increases because of inflation. In such a climate why should the Federal government be considering cutting back on Federal employees' benefits? It should be proposing to improve employee benefits. A more generous retirement system is needed to make up for the less generous pay and other fringe benefits.

The Federal deficit will not be cured by reducing Federal employees' pay package. However, if the Federal employee is made, incorrectly, to seem overpaid, the public's attention is focused on that misconception, rather than on facts such as that some individuals and corporations are not required to pay their fair share of taxes and that the American public is subsidizing through taxes some activities which it most certainly would not want to, if the facts were known and publicized.

Much has been made of the so-called burden of the American taxpayer in paying for Federal employees' pensions. PMA would like to point out that the American taxpayers employ the Federal employee and thus pay for our salaries and some of our benefits. However, little has been made of the fact that the American taxpayers are also subsidizing every private-sector employee's salary and pension because these are expenses which are deductible from their employer's taxes, are thus a revenue loss to the Federal government, and therefore are activities subsidized by the American taxpayer. Let us not forget that the American taxpayers are subsidizing J. Peter Grace's pension of over $357,000 per year. The American taxpayers are subsidizing lavish business lunches, extravagant business entertainment, and planes and yachts and resort condominiums owned by corporations and flights on the Concorde taken by business executives. The American taxpayers are subsidizing those 40 large, profit-making firms that paid no income taxes in 1984 (according to the August 29, 1985 issue of the Wall Street Journal). PMA believes that the purpose behind some organizations' misrepresentations to the public on Federal pensions and other Federal expenditures is not a public-spirited one, but a self-serving one. The purpose of these groups' misleading the public about such matters is to keep public attention away from the real tax inequities in our society from which they benefit so lavishly and which we taxpayers are subsidizing. They want to concentrate attention on cutting Federal expenditures, whether fairly and wisely or not, so that our tax structure is not scrutinized.

Finally, we would like to make two points with respect to how the new plan will take into account the Social Security benefits earned. Since Social Security replaces a higher proportion of earnings for low-wage employees, it is not unreasonable that this "tilt" be taken into account. We note that the proposed plan does not take the "tilt" into account. We prefer that an "add on" approach be utilized because it is easier for employees to understand than an "integrated" approach. Perhaps an "add on" approach could be utilized with a higher rate of accrual for salaries over a specified level in order to make up for the Social Security "tilt". But, regardless of how Social Security is taken into account, it is very important that only that part of an employee's Social Security benefit attributable to Federal service be taken into account. If a specified percentage of an employee's entire Social Security is taken into account, even that part of Social Security attributable to private-sector employment, then Federal employees who have also worked in the private-sector will lose some or all of their benefits from the Federal retirement plan.

We hope you will keep our concerns in mind when you consider this legislation. PMA earnestly desires that the plan adopted for Federal employees hired after December 31, 1983, be one which will enable retirees to maintain their pre-retirement standard of living in their retirement years and thus will be a plan which will be instrumental in attracting and retaining an efficient Federal work force. PMA will be happy to assist you in this most important enterprise.

Senator **Eagleton**. Is Mr. Fowler here? Mr. Fowler, you were supposed to be on with Ms. Benson. We are sorry we juggled the schedules' It is our fault. Would you like to come forward now?

Mr. **Fowler**. Yes.

Senator **Eagleton**. Mr. Fowler, you may proceed. Mr. Fowler is representing the National Association of Postmasters of the United States.

TESTIMONY OF AL FOWLER, POSTMASTER, COLUMBIA, MD, NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES, ACCOMPANIED BY THOMAS R. ROTH, CONSULTANT TO NAPUS

Mr. **Fowler**. Mr. Chairman, members of the committee, my name is Al Fowler. I am the postmaster for Columbia, MD. I am the former president, past State secretary and State treasurer, past State labor-management chairman——

Senator **Eagleton**. You are past everything.

Mr. **Fowler**. Yes and I almost passed out on the way over. We were in a taxi which a truck ran into, so I am glad for the schedule change. So based on that, we are starting at the bottom and going to the top.

Today, I am representing Tom Costin. Tom is presently leading the postmasters at the national convention in Las Vegas, NV. Appearing with me is Mr. Thomas R. Roth, economic consultant to our organization.

We greatly appreciate this opportunity to testify on behalf of the nation's 29,700 postmasters regarding the critically important issue of designing a new retirement system for postal employees and other Federal employees covered by Social Security. In developing our position in this matter, NAPUS has outlined several important objectives or standards against which any proposed plan should be judged. We have carefully examined the retirement program set forth in S. 1527 introduced by Senators Ted Stevens and William V. Roth in connection with our major objectives and, regrettably, have come to the conclusion that we cannot support that proposed plan 1n its present form.

We are grateful, nevertheless, for the committee's diligence and obvious hard work in preparing this proposal. The postmasters are anxious to make whatever contributions to this committee we can to expedite the process of establishing a supplemental plan before post-1983 hires are confronted with the anticipated 14-percent pension contribution.

Our major objectives to the design of the supplemental program as proposed under S. 1527 are in the prepared statement forwarded to the committee. At this point, I will summarize the major points with Mr. Roth and respond to any questions the committee might have.

Central to our position is the need to preserve pension compensation at the level present in the current CSRS. NAPUS has advocated from the outset a pension program which would set pension compensation for Social Security covered employees at the same level as non-Social Security covered employees by equalizing employer pension costs between the two groups. The new supplemental plan, exclusive of Social Security, should carry a normal cost to the employer of approximately 18.64 percent of payroll.

The Stevens-Roth proposal would establish the employer cost at approximately 14.7 percent. This represents a cut in pension compensation for postmasters of over 21 percent. Moreover, a full 3 percent of the 14.7 percent is supposed to come in the form of a voluntary capital accumulation program.

The estimated 3-percent value assigned to the capital accumulation program assures average participation of 60 percent. We doubt that the postmasters' participation rate will be this high. Therefore, the overall value of the proposed plan is exaggerated to begin with.

The point is that the main elements of the proposed plan must be substantially upgraded simply to preserve that portion of the total compensation presently devoted to retirement income. The principle of equal pay for equal work among all postmasters, regardless of their date of appointment, is perhaps an old-fashioned idea, yet a fundamentally important goal in compensation policy which must be pursued here. NAPUS must unavoidably oppose this bill or any other which seeks to cut pension compensation for new employees through the establishment of a supplemental plan, which, when added to Social Security, falls far below the present civil service standards.

What is most disturbing is that the Stevens-Roth proposal accomplishes this cut in pension compensation by watering down or eliminating certain important features of the present CSRS. Notably, the proposed plan worsens the eligibility requirements for unreduced retirement benefits which are presently 55 with 30 years of service.

Obviously, some individuals retire at the first opportunity. Early retirement is important for some people. For individuals who can no longer tolerate the strain and pressures of work after having served with what anyone would consider a full work life, the 55/30 rule provides a useful and desirable alternative. It is an extremely important feature of the current plan which should be preserved in the new supplemental program.

The value of the present post-retirement escalation clause is also greatly diminished under S. 1527. Presently, CSRS retirees receive adjustments equal to changes in the CPI. Under the proposed plan, annual adjustments will be limited to 2 percentage points less than changes in the CPI.

The full percentage escalator provision in the proposed CSRS is one of the most significant features of the plan. To be sure, the retirement benefit, which may otherwise be adequate at the point of retirement, will steadily dissolve in real terms over the person's retired life if not adjusted in accordance with advancing prices. The provisions of S. 1527 guarantee a drop in the real value of annuities by 2 percent per year.

Over the average life expectancy of a retiree, this amounts to a more than 46-percent cut. Changes in certain key features of the present CSRS of this kind make the proposed plan unacceptable to the Nation's postmasters.

We are, of course, aware of those who criticize the CSRS for its alleged high costs and unique provisions. We acknowledge, for example, that eligibility requirements for normal retirement and post-retirement adjustment provisions under the CSRS are not found in the average private sector plan.

However, when total compensation is examined, Federal workers have already fallen far behind their private sector counterparts. The Federal Pay Comparability Act of 1970, Public Law 91-656, was designed by Congress to provide an equitable and fair method for setting federal pay by comparing adequate rates to those in the private sector. Two weeks ago, the President's pay agent reported that under existing comparability law, the computation based on this year's survey indicates an upward adjustment in Federal pay rates by 19.15 percent.

The uninformed assume that this enormous pay gap will disappear when the benefits structure in federal employment, including CSRS, is taken into account. This is simply not the case.

The public's perception of the benefits structure in Federal service was formed in the early 1960's when, indeed, it was enviable by private employment standards. But the basic elements in the civil service and postal service benefits package have been the same for over 20 years. Progressive change and constant liberalization has characterized the private sector development of benefit plans over the past few years, while in the Federal sector, benefits have stayed the same or have been worsened.

The Hay study cited earlier found in several benefits areas, Federal Government practice laps behind the private. sector. Any advantage gained under the civil service retirement system is all but eliminated when the deficiencies elsewhere in the tringe benefit programs are included. When total compensation is examined, there is no escaping the conclusion that Federal workers are already paid less than their cohorts in private industry.

The Stevens-Roth proposal cuts pension compensation from the present 24.7 percent to 20.6 percent of payroll, thereby widening the Federal lag in total compensation behind the private sector by an additional 4.1 percent of pay.

In view of the already serious gap between Federal and private compensation, reducing the pension portion of compensation to conform to private sector levels is simply unfair and unjustifiable.

Thus far we have focused our comments on the all-important objective of maintaining pension compensation at a level equal to the value of the present CSRS.

There are, of course, several other important issues regarding the specific design of the new retirement system which have not been discussed. Two design issues, the method of Social Security integration and the role of the capital accumulation program, require attention at this time.

We know that under the present CSRS, the relationship between pension income and preretirement earnings is the same across all income levels. Social Security, on the other hand, places a higher proportion of pre-retirement earnings for those at the lower end of the income scale. The Stevens-Roth proposed plan preserves the Social Security tilt completely by making basic retirement benefits fully additive to Social Security. This creates a particularly vexing problem for NAPUS. Our organization represents postmasters with an average annual salary of approximately $30,000. Salaries range, however, from under $4,500 to over $60,000. We represent part-time postmasters in the rural areas, where salaries are predicated on 2 to 6 hours of work per day, together with some of the highest paid postal managers, responsible for the entire operation of the largest postal facilities in New York, Baltimore, Washington, Chicago, and other metropolitan areas.

This sprawling range of salaries leads us to conclude that the costs and benefits of the new retirement system should be distributed equally among the salary range. We are convinced that the fairest and most equitable treatment of with all Federal workers, with regard to distribution of benefits, requires the duplication of the current civil service retirement system structure to the maximum possible degree.

This, of course, dictates a new supplemental plan which incorporates an offset of 100 percent of the primary Social Security benefit, or as great an offset as practicable. The objective is to design a program which replaces the same percentage of preretirement earnings regardless of the job classification or rate of pay.

With respect to the voluntary capital accumulation plan, it is our position that it represents far too great a portion of the proposed retirement system under S. 1527.

We are not opposed to a thrift payment plan, per se, but we are uncertain as to its value in the overall program. We are uncertain of the degree of participation. The 60-percent assumption seems too high for postmasters, let alone lesser paid groups. We are uncertain of the distribution of employer contributions devoted to this element of the plan. It is likely that participation rates will increase with salary, thus allocating a disproportionate share of the value to the highest paid classifications, and of course, we are uncertain of the benefit level which is ultimately achieved and which is of primary importance in deciding when or if to retire. After all, the benefit level is a function of the investment earnings over the life of the individual's account.

For the same employer contribution, we prefer to allocate more pension compensation to basic benefits which are evenly distributed among all income levels and which are not contingent on an employee's ability to generate additional savings.

While we are not dogmatically opposed to capital accumulation programs, we regard them as a third and separate tier of pension development which should be secured only after a solid core of employer-paid benefits is obtained. The capital accumulation approach should be considered in the next generation of pension plan provisions, the kind which might, for instance, eventually supplement the civil service retirement system benefits of incumbent Federal workers. At this stage, however, we oppose the capital accumulation plan approach as a substitute for cost-equivalent pension benefits.

In summary, NAPUS advocates the pension program containing the following central theme:

One, pension compensation for Social Security covered employees at the same level as non-Social Security covered employees by equalizing the employer pension costs between the two groups;

Two, distribution of the costs and benefits uniformly across job classifications and salary levels, thereby duplicating the structure of the present civil service retirement system;

Three, heavy weighting of costs and benefits on the basic benefit formula without the use of contingent benefits associated with a voluntary capital accumulation plan;

Four, preservation of the main features of the present civil service retirement system in the areas of post-retirement adjustments, vesting and early retirement.

We urge the committee to give full and careful consideration to these essential objectives. A retirement program designned in conformance with these principles provides the fairest and most equitable adjustment of taxpayers' and employees' interests at this point in time. Moreover, the preservation of pension compensation is critically important to the Postal Service if it is to continue to attract and retain qualified, capable managerial personnel.

Thank you, Mr. Chairman and members of the committee, for having provided this opportunity to express the views of the National Association of the Postmasters of the United States.

Senator STEVENS. Thank you very much.

I appreciate your comments. Senator Eagleton has asked that I ask you if your position is that new employees should have to contribute the same percentage of their pay for retirement as old employees? That is, should there be a level contribution between old and new retirement programs?

Mr. FOWLER. We feel that the present rate of contribution is affordable to all employees, and we feel that as employees, having spent 20 years in the Postal Service myself, we are having indications that there is an uneven distribution of benefits coming into the Postal Service now.

We feel that if you have to have a system that supplements the Social Security, it should be along the same amount of benefits they are paying at the present time.

Senator STEVENS. We are not talking about benefits. We are talking about contributions. Under our plan, it is a 7-percent contribution. Under the old plan, it is 8.3. He has been asking everyone, do you believe that we should require new employees to contribute 8.3, even though we can finance the plan with 7 percent?

Mr. FOWLER. I don't feel NAPUS can take the position that we favor the 1.3 add-on. There are instances where this is not going to benefit anyone who has been under the civil service retirement system since the first inceptions. We do not favor the 8.3.

Mr. ROTH. I might also add, sir, if I may, that the issue as we see it is the fixing of pension compensation, which is measured by the contributions that the employer gives to the benefit structure. Obviously, a pension with respect to the size of the employee contribution depends on the benefits which flow from those contributions.

Our view is that pension compensation ought to be equalized between the incumbent postmasters and those hired in the post-1983 era. That is to be valued and measured as the employer contribution; if new hires are to receive pension compensation or benefits which exceed those of incumbents, then those should justify contributions on their own part, which are higher than the incumbents.

After all, you get what you pay for. Currently, there are vehicles for postmasters to expand on their retirement income by participating in individual retirement account programs as sponsored by their organization. I am sure there are other ways of disciplining the contributions that enhance their own income.

Senator STEVENS. Then if you have IRA's—this should be no news to you—but I was surprised to find that the largest group of IRA's is owned by the younger, middle-aged group. This article I have points out that a survey by Sindlinger & Co. has found that the younger consumers between the ages of 25 and 34 own two-thirds of all of the IRA's. Two-thirds of the IRA buyers are under 45. It is, in fact, the younger people that are buying IRA's.

Mr. ROTH. That doesn't surprise me. I think it is one of the reasons why NAPUS advocates the greater weight placed on the defined benefit program.

The IRA's or any 401(k) program are of great advantage to those employees who are in the early years of their careers and who plan to make career moves. It enables the employees to maximize their portability from one job to another, but we are representing a group of persons who are career Postal Service employees. They don't become postmasters until they have made all of the anticipated career moves, so to speak, and there is no advantage to this group of Federal employees in the portability aspects or advantages of a capital accumulation program of the kind you are speaking of.

Senator STEVENS. There is no advantage to having 5 percent of the contribution matched when the group you are talking about—37 percent of all IRA's are held by middle-income individuals with salaries between $15,000 and $30,000? Witness after witness is telling us that these middle-income people aren't going to be interested in a plan that matches contribution. I just don't believe that. These people participating in IRA's get no match. IRA's just amount to deferred income.

We have both deferred income and a matching plan of up to 5 percent of your salary matched by your employer, if you save. The record shows that they are the ones who are saving already.

Mr. ROTH. What we are saying is that that may well be true, but the characteristics of the group that you cite as being most advantaged and taking part in these IRA programs simply don't match the group we represent. We are talking about long service, career-oriented postal workers.

These persons are going to retire from the Postal Service. It is the main objective of postmasters to design a retirement program which provides and maximizes retirement income, not portability of pension income.

Portability to this group is not that important.

Senator STEVENS. Portability is secondary to the third tier. We didn't put it in there primarily because of portability.

Mr. ROTH. We agree with that.

Senator STEVENS. We put it in there because of the fact that it has the greatest earning capacity capability of the whole system, more than Social Security, more than the pension. The third tier is controllable by the employee and can be enhanced more than the other two.

It is not dependent upon Congress. Congress can't change that.

Mr. Roth. Those features certainly are attractive to anyone. Again, we, as Mr. Fowler stated, don't oppose the inclusion of the capital accumulation program as such. It has all of the virtues that you say it does.

It is the weight that that element in the holdover of the retirement program carries that is objectionable here. As a substitute for a specific, a known, defined benefit program, which has benefits which are evenly distributed against all occupational lines, it is simply not as attractive.

Senator Stevens. Suppose we gave your people the option: They could put their 1.3 percent into a defined benefit plan, or they could put it into a thrift plan or whatever else. Do you think most of your people would elect to put the 1.3 in to the defined benefit plan?

Mr. Roth. This would be apart from any employer contributions? Is that what you mean?

Senator Stevens. It would reduce the matching on the thrift plan. You say that more people would want the defined benefit plan. Suppose we put part of that in the defined benefit but limit those people to the amount that can be matched under the thrift plan.

Mr. Roth. Again, it is an attractive proposition to the extent that it is to supplement what is otherwise established as a retirement program with equal value to the current CSRS.

Senator Stevens. By definition, we are not going to get that. I don't think anyone in this room believes that we can come out with a plan that will be as good as the civil service retirement system for those people who are included in Social Security now. You don't really believe that, do you?

Mr. Roth. Of course, we are talking about the supplemental plan which, when added to Social Security, is the CSRS. If you are asking me whether I believe that is feasible or not, politically, I have no judgment; but certainly, to ask us to support a cut in pension compensation for postmasters of 20 percent, I think, is unfeasible.

Senator Stevens. I don't blame you for asking.

Mr. Roth. I certainly don't blame you for asking.

Senator Stevens. Thank you very much, gentlemen. We appreciate your testimony.

Mr. Fowler. Thank you, sir.

Mr. Roth. Thank you, sir.

[Mr. Fowler's prepared statement follows:]

September 10, 1985

STATEMENT OF

AL FOWLER

National Association of Postmasters of the United States

Mr. Chairman, members of the Committee - my name is Al Fowler. I am the Postmaster for Columbia, Maryland. Today I am appearing on behalf of the National Association of Postmasters of the United States. Appearing with me is Mr. Thomas R. Roth, economic consultant to our organization.

We greatly appreciate this opportunity to testify on behalf of the nation's 29,700 Postmasters regarding the critically important issue of designing a new retirement system for Postal employees and other Federal employees covered by Social Security. In developing our position in this matter, NAPUS has outlined several important objectives or standards against which any proposed plan should be judged. We have carefully examined the retirement program set forth in S. 1527 introduced by Senators Ted Stevens and William V. Roth in connection with our major objectives and, regrettably, have come to the conclusion that we cannot support that proposed plan in its present form.

Central to our position is the need to preserve pension compensation at the level represented by the current CSRS. NAPUS has advocated, from the outset, a pension program which would set pension compensation for Social Security-covered employees at the same level as non-Social Security-covered employees by equalizing employer pension costs between the two groups. In determining the "equal value", we endorse the employer-normal-cost approach developed by the Congressional Research Service (CRS) in its December 1984 report on designing a retirement system for federal workers covered by Social Security. Accordingly, the new supplemental plan (exclusive of Social Security) should carry a normal cost to the employer of approximately 18.64 percent of payroll. Under the CSRS actuarial cost model, this equals the employer's normal cost of CSRS, net of administrative expense (.05%), and the cost of unique provisions for special groups (.45%), less the employer's normal cost for Social Security (6.06%).

The Stevens-Roth proposal would establish an employer cost of approximately 14.7 percent. This represents a cut in pension compensation for Postmasters of over 21 percent. Moreover, a full 3.0 percent of the 14.7 percent is supposed to come in the form of a voluntary capital accumulation program. The estimated 3.0 percent value assigned to the capital accumulation program assumes average participation of 60 percent. We doubt that the Postmasters' participation rates will be this high; therefore, the overall value of the proposed plan is exaggerated to begin with.

The point is that the main elements of the proposed plan must be substantially upgraded simply to preserve that portion of total compensation presently devoted to retirement income. The principle of equal-pay-for-equal-work among all postmasters, regardless of their date of appointment, is perhaps an old fashioned idea yet fundamentally important goal in compensation policy which must be pursued here. NAPUS unavoidably must oppose the Stevens-Roth bill, or any other, which seeks to cut pension compensation for new employees through the establishment of a supplemental plan which, when added to Social Security, falls far below the present Civil Service standard.

What is most disturbing is that the Stevens-Roth proposal accomplishes this cut in pension compensation by watering down or eliminating certain important features of the present CSRS. Notably, the proposed plan worsens the eligibility requirements for unreduced retirement benefits. Presently, employees can retire at age 55 with 30 years of service, at age 60 with 20 years or at 62 with 5 years. Under the new plan, unreduced retirement is available only upon attaining 62 years of age with 5 years of service. Retirement before age 62 results in significant benefit reductions.

There is no evidence to support the notion that liberal eligibility rules are excessively costly or cause a mass exodus of eligible workers. The fact is that early retirement is not convenient or desirable for every worker. The vast majority of employees eligible for early retirement prefer to continue on the job -- to realize higher pension benefits and complete a full worklife. The latest OPM data show that federal workers retiring under the 55/30 rule make up only 26 percent of all annuitants; the average service of this group is 34.4 years -- a complete worklife by any standard. Overall, the average age of federal annuitants on the date of retirement is 61.0 for normal retirement. Moreover, there is no apparent difference between retirement patterns under CSRS and those typical in American industry. For example, 75 percent of all workers retiring voluntarily under Social Security today do so before reaching age 65. A survey of corporate experience conducted by the actuarial consulting firm Johnson and Higgins found that the average retirement age was 61.8 among 72 responding companies; 63.4 percent retired before age 65.

Obviously, some individuals retire at the first opportunity. Early retirement is important for some people. For individuals who can no longer tolerate the strain and pressures of work, the 55/30 rule provides a useful and desirable alternative. It is an extremely important feature of the current plan which should be preserved in the new supplemental program.

The value of the present post-retirement escalation clause is also greatly diminished under S. 1527. Presently CSRS retirees receive adjustments equal to changes in the CPI. Under the proposed plan, annual adjustments will be limited to 2 percentage points less than changes in the CPI.

The full percentage escalator provision in the current CSRS in one of the most significant features of the plan. To be sure, a retirement benefit which may otherwise be adequate at the point of retirement, will steadily dissolve in real terms over a person's retirement life if not adjusted in accordance with advancing prices. The provisions of S. 1527 guarantee a drop in the real value of annuities by 2 percent per year. Over the average life expectancy of a retiree, this amounts to more than a 46 percent cut! Changes in certain key features of the present CSRS of this kind make the proposed plan unacceptable to the nation's Postmasters.

We are, of course, aware of those who criticize the CSRS for its alledged high costs and unique provisions. We acknowledge, for example, that eligibility requirements for normal retirement and post-retirement adjustment provisions under the CSRS are not found in the "average" private sector plan. Consequently there is some evidence that the overall costs, or value, of the CSRS today exceeds that which is typical in under non-government systems. For instance, the Hay Group's study of total compensation in the Federal State and Private Sectors, prepared for the House Committee on Post Office and Civil Service, shows that the employer-provided cost of the CSRS is 24.7 percent of payroll compared to 18.3 percent for the average private sector retirement system (including Social Security). But this gap has narrowed tremendously over the years and continus to close as private sector programs rapidly expand and become increasingly more adequate in providing retirement income. The CSRS was never intended to be the average program. The CSRS was established in 1920 when less than 7 percent of private sector workers were covered by a pension program. For decades it served as a model for private industry as a device to enhance efficient business operation by providing for comprehensive employee income protection, and as an efficient method for removing from active employment workers whose age or infirmities hindered job performance.

Yet the government's leadership role in this area is rapidly diminishing. The principle features of the CSRS -- e.g., the 55/30 rule was added in 1967; hi-3 became effective in 1969; the automatic escalator provision was established in the 1963 -- have remained the same for nearly 20 years during a period when private sector retirement plans developed most rapidly. In view of this trend in liberalizing private sector programs, there is no reason to cut back on the federal system in order to establish pension comparablity.

Significantly, when total compensation is examined, federal workers have already fallen far behind their private sector counterparts. The Federal Pay Comparability Act of 1970 (P.L. 91-656) was designed by Congress to provide an equitable and fair method for setting Federal pay by comparing adequate rates to those in the private sector. Two weeks ago the President's Pay Agent reported that "under existing comparability Law, the computation based on this year's survey indicates an upward adjustment in Federal pay rates varying by grade level from a low of 18.35 percent at GS-3 to 20.85 percent at GS-15. The overall average increase would be 19.15 percent"!

The uninformed assume that this enormous pay gap will disappear when the presumably generous benefit structure in federal employment, including the CSRS, is taken into account. This is simply not the case. The public perception of the benefit structure in federal service was formed in the early 1960's when indeed it was enviable by private employment standards. But the basic elements in the civil service and postal service benefit package have been the same for over 20 years. Progressive change and constant liberalization has characterized the development of private sector benefit plans over the past few decades while in the federal sector, benefits have stayed the same or have been worsened.

The Hay study, cited earlier, found that death benefits, disability income replacement benefits and health benefits, are now significantly lower in the federal government than in the private sector. Any advantage gained under the CSRS is all but eliminated when the deficiencies elsewhere in the fringe benefit programs are included. When total compensation is examined, there is no escaping the conclusion that federal workers are already paid less than their cohorts in private industry. The Hay study put it in these terms:

> Since cash compensation and fringe benefits other than retirement are more valuable in the private sector, the total compensation perspective shows that Federal employees' total compensation is 7.2% behind the private sector on average. As a result, even if a supplemental retirement system is linked with social security to produce benefits that are comparable to those available to Federal employees hired before January 1, 1984, the total compensation available to new Federal employees will also lag the private sector. Federal employees' total compensation is 7.1 percent ahead of the total compensation of State employees. When the two data bases are combined, the total compensation of Federal employees lags the total compensation of other employees by 6.2 percent. It is expected that the 1985 update of this analysis will increase the advantage of private sector total compensation to 9 percent or more.

The Stevens-Roth proposal cuts of pension compensation from the present 24.7 percent to 20.6 percent of payroll, thereby widening the federal lag in total compensation behind the private sector model by an additional 4.1 percent of pay. In view of the already serious gap between federal and private compensation, reducing the pension portion of compensation to conform to private sector levels is simply unfair and unjustifiable.

Thus far we have focused our comments on the all important objective of maintaining pension compensation at a level equal to the value of the present CSRS. There are, of course, several other important issues regarding the specific design of the new retirement system which have not been discussed. Two design issues -- the method of Social Security integration and the role of the capital accumulation program -- require attention at this time.

We know that, under the present CSRS, the relationship between pension income and preretirement earnings is the same across all income levels. Social Security, on the other hand, replaces a higher proportion of preretirement earnings for those at the lower end of the income scale. The Stevens-Roth proposed plan preserves this Social Security "tilt" completely by making basic retirement benefits fully additive to Social Security.

This creates a particularly vexing problem for NAPUS. Our organization represents Postmasters with an average annual salary of approximately $30,000. Salaries range, however, from under $4,500 to over $60,000. We represent part-time Postmasters in the rural areas whose salaries are predicated on 2 to 6 hours of work per day, together with some of the highest paid postal managers, responsible for the entire operation of the largest postal installations in New York, Baltimore, Washington, Chicago and other major metropolitan areas.

This sprawling range of salaries leads us to conclude that the costs and benefits of the new retirement system should be distributed equally across the salary scale. We are convinced that the fairest and most equitable treatment of all Federal workers, with regard to the distribution of benefits, requires the duplication of the current CSRS structure to the maximum possible degree.

This, of course, dictates a new supplemental plan which incorporates an offset of 100 percent of the primary Social Security benefit, or as great an offset as practicable. The objective is to design a program which replaces the same percentage of preretirement earnings, regardless of job classification and rate of pay.

With respect to the voluntary capital accumulation plan, it is our position that it represents far too great a portion of the proposed retirement system under S. 1527. We do not believe that the assumed participation rates of 60 percent will ever be achieved for Postmasters, let alone for those groups of federal workers with lower earnings and less ability to generate voluntary contributions. More important, however, is the fact that, at any level of average participation, participation will not be evenly distributed. It is likely that participation rates will increase with salary, thus allocating a disproportionate share of the value to the highest paid classifications. For the same employer contribution, we prefer to allocate more pension compensation to basic benefits which are evenly distributed among all income levels and which are not contingent on the employees' ability to generate additional savings.

While we are not dogmatically opposed to capital accumulation programs, we regard them as a third and separate tier of pension development which should be secured only after a solid core of employer-paid benefits is obtained. The capital accumulation approach should be considered the next generation of pension plan provisions -- the kind which might, for instance, eventually supplement the CSRS benefits of incumbent Federal workers. At this stage, however, we oppose the capital accumulation approach as a substitute for cost-equivalent basic pension benefits.

Summary

The Postmasters' position on the issues treated hereinabove, as well as other design issues, is expressed in the following outline which sets forth the details of the supplemental retirement plan which we are willing to support:

• Pension Benefit Formula	1.78 percent of high-3 x years of service.
• Social Security Coordination	Less 100 percent of Social Security.
• Post-retirement Adjustments	100 percent of the CPI increase.
• Eligibility Requirements for Unreduced Benefits	Age 55 with 30 years, or Age 60 with 20 years, or Age 62 with 5 years.
• Social Security Supplement	Payable between ages 55 and 62; equal to the Social Security benefit payable at age 62.
• Vesting	5 years, payable beginning at age 62.
• Disability	Applicable to any person who is unable to perform in position during first 24 months; after 24 months, payable if totally and permanently disabled for any occupation; benefit equal to 60 percent of predisability pay less Social Security, or accrued retirement benefit, whichever is greater.
• Survivor Benefits	For preretirement death, 55 percent of accrued retirement benefits. For postretirement death, if elected, a reduction in the retirement annuity of 2.5 percent of first $3,600 annually, plus 10 percent on amounts over $3,600. Survivor benefit is calculated at 55 percent of annuity before reduction.
• Employee Contributions	None.
• Capital Accumulation Plan	None.

A pension program containing these central ingredients does not exceed the costs of the current CSRS and accomplishes several objectives critical to our organization:

(1) It sets pension compensation for Social Security-covered employees at the same level as non-Social Security-covered employees by equalizing employer pension costs between the two groups.

(2) It distributes the costs and benefits uniformly across job classifications and salary levels, thereby duplicating the structure of the present CSRS.

(3) It places the weight of costs and benefits on the basic benefit formula without the use of contingent benefits associated with a voluntary capital accumulation plan.

(4) It preserves the main features of the present CSRS in the areas of post-retirement adjustments, vesting, and early retirement.

We urge the Committee to give full and careful consideration to these essential objectives. A retirement program designed in conformance with these principles, provides the fairest and most equitable adjustment of taxpayers' and employees' interests at this point in time. Moreover, the preservation of pension compensation is critically important to the Postal Service if it is to continue to attract and retain qualified and capable managerial personnel.

Thank you, Mr. Chairman, and members of the Committee, for having provided this opportunity to express the views of the National Association of Postmasters of the United States.

Senator STEVENS. Our next witnesses are Mr. James Peirce, President of the National Federation of Federal Employees; Robert Tobias, national president of the National Treasury Employees Union; and Ed Murphy, legislative counsel of the National Association of Government Employees.

Gentlemen; and Ms. Thomas, it's nice to see you, too. Jim, you are first on our list. If that is all right with everyone else, why don't you leadoff?

TESTIMONY OF JAMES M. PEIRCE, PRESIDENT, NATIONAL FEDERATION OF FEDERAL EMPLOYEES, ACCOMPANIED BY PATRICIA THOMAS, LEGISLATIVE DIRECTOR, NFFE; ROBERT M. TOBIAS, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION; AND EDWARD L. MURPHY, LEGISLATIVE COUNSEL, NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

Mr. PEIRCE. Thank you, Mr. Chairman. Mr. Chairman and committee members, I appreciate the opportunity to testify today on S. 1527, a bill which Senator Stevens and Chairman Roth have introduced to establish a new retirement system for Federal employees hired after 1983.

S. 1527, the Civil Service Pension Reform Act of 1985, represents a good start toward designing a retirement system, and I commend the sponsors for your efforts to develop the plan before the January 1, 1986 deadline.

Throughout the discussion of the new supplemental retirement plan, NFFE has urged Congress to develop a system which would provide a level of benefits comparable to the current program. It would be a disaster to create a new program that did not continue to protect the Government's expertise and institutional knowledge. NFFE has also stressed that cost savings should not be the primary factor in establishing a new system.

The last thing we want is a cheap retirement plan. The modification of the three essential elements of the current CSRS, which S. 1527 proposes, is, therefore, a cause of great concern. The benefits to which I refer are early retirement, cost-of-living adjustments and the high 3 benefit calculation, all of which are valuable components of the current Federal annuity package.

We must also ensure that we retain early retirement and other benefits for special category employees such as law enforcement officers, firefighters, National Guard technicians, air traffic controllers and so forth.

With pay rates and total compensation so low in comparison to the private sector, retirement is one of the few remaining incentives to stay in the Federal work force. Should civil service retirement also fall below private sector standards, the Government would find it virtually impossible to recruit and retain talented employees.

These changes over the CSRS not only threaten future retirees hired after 1983 whose benefits would be significantly reduced, they also set a dangerous precedent for the current system. I, therefore, urge the committee to consider carefully the damaging effect on both annuities and employee morale such reductions would have.

I would like now to address the thrift portion of the new supplemental retirement plan, which, aside from Social Security coverage, is the most significant change in the current system. While the concept of the thrift plan has merit, there are inherent difficulties in both its application and administration. In addition, the plan does not give the employee significant control over the management of his or her account.

The thrift plan, as it is now envisioned, leaves me with four immediate concerns. They are: One, the effective management of potentially vast sums of money in the thrift plan and their impact on the economy; two, the creation of a new Government entity with appointed individuals who more than likely do not have the necessary expertise to administer the thrift plan funds; three, the strong economic power base such individuals would hold; and finally, the restriction of an employee's fundamental right to choose where his or her contributions should go.

As more and more employees join the Federal work force, and participate in the thrift plan, a huge sum of money will be available for investment. In fact, the fund will be the largest single employer thrift plan in the world and, as such, will have a significant impact on the economy. As the funds accrue, they could increase to such monumental proportions as to be completely unwieldy and possibly economically threatening. According to our estimations, the thrift plan could accumulate approximately a one-half trillion dollars in 3 years and $1 trillion in 4 years.

Without a doubt, this vast sum of money would have a significant impact on the business world.

While it is true that private pension funds now hold approximately $1.3 trillion and absorb $100 billion a year, these funds are held by individual pension funds. There is no single board which decides how these private pension funds are invested.

Yesterday Mr. Fossel commented in relation to whether or not these funds might control the market. He said, "In my opinion, these fears are wholly unfounded. In the first place," he said, "the proposed act provides for a very gradual phase-in in the private sector investments. Second, the current and prospective size and liquidity of the U.S. financial markets make it highly unlikely that any responsibly managed fund, even one of this size, could have undue influence in the market."

This statement is contrary to the NBC white paper aired several weeks ago relative to the $1.3 trillion in the private sector fund. I think the capability of influence in this area, as far as the board and so forth, would be significant. It would have a significant impact in influencing the ceremony.

S. 1527 would create a board which would be making decisions controlling almost $1 trillion. As you can imagine, the potential economic power of the civil service pension system thrift plan managers would be enormous. My concerns lie in the ability to ensure adequate protection against financial manipulation by the thrift plan administrators. I am not yet confident that these protections can be made strong enough.

Again, Mr. Fossel said,

> It is clearly in the best interest of all concerned to set up the civil service thrift investment board in such a way as to provide the most professional understanding of pension and investment issues.

I think that is great, but I don't think we can assure that through political appointees and other appointees.

He went on to say that it was his view that the board should consist of employee, employer, and political representatives and should assume broad policymaking and oversight responsibilities including: investment policy formulation, asset allocation, legal and contractual oversight, hiring the executive director, and so forth. That is scary.

He also stated that in order for the fund to be best able to achieve its long range objectives for its participants, it is paramount that the executive director, the professional staff and its thrift plan managers be as far removed from political interference as possible. He went on to say that there are too many examples where this did not happen and had quite negative results.

I just can't see any way of establishing an entity in the Federal Government that can give us these assurances.

I guess I would like to relate——

Senator STEVENS. We would like to check your numbers on that. Your projection of $1 trillion is about 100 times larger than our projection, and the projections that we have seen indicate that somewhere around $45 billion after 20 years, is what we are talking about.

If you take the current system, the contributions are greater in the current system than they would be under the thrift plan, and there is nowhere near $1 trillion in the fund right now, as you know.

Mr. PEIRCE. I realize that, but there has been no accumulation there, either. I will be glad to give you our projections and the basis upon which we made the projections. I will furnish those to the committee.

Senator STEVENS. We would like to have them.

Mr. PEIRCE. The other thing that Mr. Fossel also inferred to was whether there should be both internal and external management as far as this system is concerned; he seemed to be indicating contracting out, because he alluded to the fact that many major funds did contract out the management.

Still, the cost, the influence involved there really is something that I feel is very dangerous. I think there is a way that we can get away from this, even the potential danger, by, No. 1, not having such a program.

The size of the Government entity required to actually administer this plan would have to be enormous to properly manage and invest such a large fund. I do not believe that, as S. 1527 is currently written, either the investment board or the advisory committee can adequately meet their responsibility. Not only would it be difficult to attract the high caliber employees needed to fill this mandate, but appointed individuals with little or no investment experience would wind up making the final decisions. I am not confident that the best decisions would be made.

Finally, the thrift plan fails to give employees adequate control over their thrift account. Although the thrift plan provides employees with vehicles by which to invest their funds, it takes away their independence to make such decisions for themselves.

You would do a great injustice to civil servants by underestimating and limiting their ability to determine their own retirement investments. The Federal work force is better educated and more professional than at any other time in its history. It is essential, then, that its employees be given the right to control their own retirement future.

Senator STEVENS. Are you suggesting that the cost of the individual thrift accounts is excessive?

Mr. PEIRCE. Private sector——

Senator STEVENS. People feel the most successful IRA's are those that are umbrella IRA's with some major insurance company, or something like that, where the management costs are shared and the revenues enhanced. The individual IRA, the person managing his own, has the lowest return.

Mr. PEIRCE. I think there again, I can furnish you some information on that side of it.

The committee could grant this right by amending title I of the Civil Service Pension Reform Act of 1985 to designate where their funds will go. Literally speaking, in the private sector, there are all sorts of markets there which the employee could be attracted to.

Senator STEVENS. That is true, but in this instance they have half of the money as the employer's money. The employees who made their own decision to put their moneys in savings and loans in Maryland, in their IRA's, made that decision, but it was their own money. It was not an employer contribution which was put there for the purpose of avoiding future COLA's.

We think we have a management responsibility to assure that the thrift funds are managed properly. That is why the board has been created, Jim.

Mr. PEIRCE. I think the vehicles are there by which this can be done, and I think I can bring them to your attention. There are insurance funds sitting out there. There is just about anything that you want.

There again, by legislation, the thrift fund that the Federal employees can utilize can be structured by legislation. 401(k)'s and IRA's right now have to meet those requirements.

Senator STEVENS. These funds could be invested in similar investments, not necessarily turned over to similar management. That is the difference. I don't think we want the funds turned over on an individual basis to a local savings and loan that is a State-chartered savings and loan. I don't think you would want that, would you?

Mr. PEIRCE. I am not talking about that aspect of it. But there again, the investing right is still a feature that could remain, and the funds could be so structured to accommodate that. I think there is no problem with that.

Senator STEVENS. Sorry I interrupted you. Go ahead, Jim.

Mr. PEIRCE. The design of a system that encompasses both a defined benefit, defined contribution and Social Security contribution is a formidable task. I must therefore commend the chairman and Senator Stevens for undertaking this task and for moving the new supplemental retirement system from discussion toward implementation. I hope the committee will consider NFFE's concerns and suggestions and continue to work with us to develop a secure retirement system for our future retirees. I have also requested our entire statement be entered into the record. With that, I will conclude my statement and await any questions.

Senator Stevens. Thank you. Yes, we will put it all in the record.

Mr. Tobias?

Mr. Tobias. Thank you, Senator Stevens. I first wanted to commend you and the members of this committee for the very professional, intelligent and prudent manner in which you have approached this complex and difficult task.

The research, studies, and legislative drafting work completed by this committee stand in sharp contrast to the haphazard and myopic manner in which this administration has tried to advance changes in the civil service retirement system, make proposals for this retirement plan and propose changes in other areas involving the pay, benefits and working conditions of Federal employees.

In the short time remaining in this session of the Congress to consider S. 1527, we hope the consideration and debate necessary to shape this retirement plan will continue to focus on the substance of this complex subject and not become a political numbers game with dollars for deficit reduction becoming the sole determinant of what this retirement plan will be.

We will eagerly work with the committee, first, to ensure a retirement plan is enacted before January 1986, and second, to ensure the plan enacted is fair, equitable, and rational.

In considering this complex legislation, we strongly believe that certain goals and objectives should be established.

Should our goal for retirement be one of enabling those in retirement to maintain their preretirement standard of living, merely meet basic needs, or something in between? We believe the goal should be that of maintaining their preretirement standard of living.

The President's Commission on Pension Salary in 1981 estimated that the average income replacement that is needed to maintain a preretirement standard of living for a single person ranged from 79 percent for the minimum wage earned to 51 percent for the highest income person. The range for married couples was 86 percent to 55 percent.

Social Security does not provide sufficient income at any level to maintain preretirement living standards. It is not intended to. As a social insurance program, its goal is to provide a floor of income protection.

The employer's—in this case the Government's—retirement program is crucial if adequate income is to be provided for maintaining a reasonable standard of living in retirement.

Coupled with the goal of maintaining a preretirement standard of living, we also believe that retirement benefits should be formerly recognized as deferred compensation earned by the employee during a working career. The objective should be to provide legal recognition of this as a guarantee that the benefits provided and promised at the time of employment will not be subsequently taken away.

This point is particularly noteworthy, as one of the purposes of S. 1527 is "to provide Federal employees with a retirement benefits plan which is comparable to good private sector retirement benefits plans." Federal employees are understandably skeptical of such a congressional statement of purpose if, in reality, the retirement benefits plan will be subject to the same whimsical, petty pickpocket ploy this administration has seen fit to inflict on the pay system.

Abandonment of the pay comparability principal and not guaranteeing a level of retirement benefits at the time of employment will have a devastating, long-range negative impact on the recruitment and retention of a competent, professionally responsible work force.

We believe that another objective of the Government's retirement plan should be to provide benefits that will attract and retain quality employees, thereby providing the incentive for the development of a well-trained, highly competent and dedicated career service. I think anything short of this objective will only encourage mobility and a high rate of turnover with disastrous results.

S. 1527 provides the basic elements for a sound, effective retirement benefits plan. However, there are some basic provisions that we believe need to be considered in order to assure a sound retirement policy and be equitable with the current retirement system for Federal employees.

The new plan should, in conjunction with Social Security, provide a level of benefits as close as possible to those under the present system. Benefits under S. 1527 will be substantially different than those received by employees covered under the current system. The defined benefit plan, plus Social Security, will provide benefits that, depending on salary, will be 5 to 34 percent less than the current system. For retirement at age 55 with 30 years service, the benefits will be 57 percent less than the current system. Even at age 60, with 30 years service, the benefits will be from 3 to 9 percent less than under the current system.

Under the proposed plan, the employees would have to participate in the capital accumulation plan in order to to meet minimum adequate income replacement and security needs. We believe the benefits from the capital accumulation plan should be at the employee's option to increase their retirement standard of living, or for other purposes, and not be calculated as part of what is necessary to maintain retirement income security. Those who cannot afford or do not want to participate in a thrift plan should not be penalized.

I should also note at this time that present income tax benefits and future income security cannot be presumed by those who participate in the thrift plan if this administration continues to push for and is successful in striking down the tax status of these deferred-income plans.

A new plan should also provide for an unreduced benefit at age 55 with 30 or more years of service.

A reduction of 2 percent for each year under age 62 flies in the face of sound personnel management and recent trends in private sector employment. It also creates an intolerable situation of two employees working side-by-side doing similar kinds of work, yet receiving vastly different benefits. Retirement with dignity and security after 30 years of service is justly deserved and, indeed, should be encouraged to maintain a work force.

The defined benefit plan provided in S. 1527 provides benefits based on years of service and salary and would merely be added to the Social Security benefits. As an "add-on" plan, it ignores the effect of the tilt in Social Security, benefiting lower wage earners and shorter career workers.

For example, the basic pension plus Social Security for an employee at age 62 with 30 years of service and a final salary of $15,000 would replace 50 percent of salary. If the final salary is $45,000, it would only replace 40 percent of salary. Offset and step rate methods of integration with Social Security are found most commonly in the private sector to balance the tilt. The step rate method formula is designed in a way that a different percentage would be applied to various levels of pay. A given percent would apply to pay up to a certain amount and a higher percent to pay above that amount.

ERISA and IRS regulations do not permit private sector plans to completely offset Social Security benefits. While the regulations are not applicable to the Federal Government, we believe that as a matter of public policy, they should be followed in the designs of this new plan. Thus, only half of the Social Security tilt could be offset. This still would leave a difference in income replacement rates between the lower paid and higher paid employees. However, these differences would only be about half the level they would under the add-on method presently in S. 1527.

There are two other basic issues in S. 1527 that require serious consideration before an overall plan could be fully considered: The salary base used to compute benefits, and protection of retirement income from inflation.

First, we believe the proposed computation rate of 1 percent per year of service on the high 5 average salary produces a benefit that is equitable only for an employee making less than $20,000. Employees earning more will have considerably less salary replacement. A slightly higher accrual rate based on the present high 3 salary will be more appropriate, particularly for employees in the $20,000 to $30,000 range.

Second, we believe that the COLA policy should automatically follow whatever policy Congress sets for Social Security. Reducing each CPI increase by 2 percent, as proposed by S. 1527, merely compounds the erosion of the purchasing power of the annuity the longer the annuitant receives the benefits, and it would become very difficult to maintain a level standard of living.

Finally, Mr. Chairman, we would like to comment specifically on the proposed new sections 8401(17) and 8411(c) relating to retirement of law enforcement officers and firefighters.

The development of a new retirement plan provides an opportunity for Congress to clarify and correct certain problems and inconsistencies that exist in the current law, and at the same time, provide for similar treatment of employees engaged in similar work under the new law.

The provision concerning coverage of law enforcement officers was initially enacted in 1947. It was primarily written to cover FBI agents. It was amended five times between 1947 and 1974 to cover certain other occupationol groups.

As a result, the broad occupational category of the position occupied became paramount rather than the actual requirements and the duties of the positions occupied.

The duties and responsibilities of both customs inspectors and IRS revenue officers more than meet the criteria established for coverage under the special provisions for law enforcement officers covered. However, because of one word in the current law, they have been denied those benefits. Their positions are not considered as primarily the investigation, apprehension, or detention of individuals suspected or convicted of offenses against criminal laws of the United States. Yet, by every other measure, these positions require the same degree of law enforcement background and exposure to hazards as other policy type functions which do qualify.

Customs inspectors today, for instance, are making an increasing number of arrests and are not allowed to perform inspector duties until qualified in firearms. Kidnapping, murder, and assault are an ever-present danger in both professions.

Similarly, IRS revenue officers are exposed to an ever-increasing number of life threatening situations in the course of their normal duties. Assaults against IRS employees increased from 531 in 1983 to 789 in 1984, a 50-percent increase.

In addition to these incidents, there are several well-financed groups around the country who advocate organized violence against IRS employees. Excluding these occupational categories is not only unfair to this group of employees, but prevents the Government as employer from maintaining a young and vigorous work force in this vital area of law enforcement.

In summary, Mr. Chairman, there are several issues to consider before this new retirement plan can be enacted. S. 1527 provides a solid basis and a conceptually sound framework within which I believe we can work to enact a retirement plan this year.

We will do all we can in working with you to enact a plan that is fair and equitable to Federal employees and the Government for which they work. I will be happy to answer any questions you have.

Senator STEVENS. Thank you very much. Let's go first to Mr. Murphy.

Mr. MURPHY. Thank you, Senator.

The Civil Service Pension Reform Act is an important first step towards the development of a supplemental retirement plan which will be fair to Federal employees, taxpayers, and consistent with the traditional goals and objectives of the civil service retirement system.

The chairman is to be applauded for taking these crucial first steps toward the development of a supplemental retirement plan.

S. 1527 is a comprehensive piece of legislation which addresses the many complex issues involved in the design of a supplemental retirement system.

The design of the bill has many positive features. The bill would significantly endorse the portability of pension benefits through the addition of Social Security and a thrift plan. The utilization in the bill of the three-tier system is a design which provides maximum flexibility to the plan. The thrift plan is an effective means of addressing Social Security tilt, since a tax-deferred savings plan will be of particular advantage to the higher paid employees.

We also support provisions in the bill providing for employee involvement on the thrift board. This is a step toward restoring credibility to the system: There has been too much distortion as to the health and stability of the Federal employee retirement system which has caused widespread confusion and a loss of confidence in the system. Employee involvement in managing the system would aid 1n arresting some of these distortions.

We also agree with provisions in the bill which have the existing fund serve both the current system and the new plan on an integrated basis. This arrangement demonstrates a commitment to continue the existing civil service retirement trust fund on a stable foundation. It is crucial that retirees under the current system be assured that the trust fund will continue on a strong financial basis.

While S. 1527 is an important first step toward the development of a supplemental retirement plan, there are substantial improvements to be made before the bill is completed. The ultimate goal, from our perspective, is to develop a system which overall will provide comparable levels of benefits as the current system with the same level of contributions from the employees.

We believe that in order to develop a plan comparable to CSRS, the cost of the plan is going to have to be roughly approximate. No amount of creativity will create a plan costing 20 percent of payroll which would provide equivalent benefits to a plan costing 25 percent of payroll.

While overall Stevens-Roth is 5 percent less expensive than the current CSRS, the defined benefit cost, including Social Security, is 17.6 percent of payroll, or some 7.4 percent less than the defined benefit portion of CSRS. This, from our perspective, is the most significant deficiency in S. 1527.

Much of the savings under S. 1527 is achieved through the proposed changes in the COLA, early retirement penalties, change from the high 5 to the high 3, and changes in the defined benefit accrual rate.

In any pension plan, there are winners and losers. Under S. 1527, those who can take the fullest advantage of a thrift plan and who need the increased portability provided by the system are the winners. The losers under this bill are those who seek an early retirement after long years of service with the Government and those who are unable to take advantage of the thrift plan.

To many Federal employees, the promise of a dignified, secure retirement at age 55 following 30 years of service, or at age 60 after 20 years of service, has been the tradeoff for inferior pay and benefits. For many of the employees NAGE represents, early retirement after long years of hard labor is not a luxury but, rather, a physical necessity. Under S. 1527, this course of action would involve substantially increased risks to the employee and his family.

It has been argued that the thrift plan will provide a means for the employee to offset the effects of the early retirement penalty by long-term investments in the thrift plan. Those employees who are in the most physically demanding positions and most in need of early retirement are most often in the lower grades and unable to take advantage of the thrift plan. Under S. 1527, early retirement might well become an option open only to the upper grades and closed to those who most need the opportunity.

The full COLA provision in the current CSRS provides retirees on a fixed income with some measure of protection against the long-term effects of inflation. Under S. 1527, this protection would be significantly diluted by providing inflation protections at the rate of CPI minus 2.

The NAGE and its members are in favor of continuing the provisions which allow for a dignified retirement at age 55 with 30 years, or 60 with no penalty following long years of service.

We urge the committee to remove the penalties for early retirement and provide full COLA protections for employees.

While we support the three-tier approach conceptually, we have always regarded the defined benefit portion of the plan as its cornerstone. Workers need the certainty and security which a defined benefit plan provides. Defined contribution plans, while allowing for greater portability, shift the risk from the employer to the employee. Retirement income thus becomes as much a factor of investment return as length of service.

We urge the committee to place a greater reliance on the defined benefit portion and less on the thrift plan as a means of providing retirement income. This could be accomplished by improving the retirement benefit formula and the salary base, and by reducing the amount of the employer's matching contribution.

The thrift plan in S. 1527 is generous. The dollar-for-dollar match on the employee's contribution is higher than is generally provided in the private sector.

We suggest that a 50 cent on the dollar match is more consistent in the private sector practice. This provision would save some 1.6 percent which should be added to the defined benefit portion of the plan.

S. 1527 relies significantly on favorable tax treatment provided to the thrift plan. With new tax reform proposals surfacing everyday, an overreliance on the favorable tax treatment of the plan is a risky enterprise. If the thrift plan such as the one in S. 1527 was taxable by the Congress, then the value of the plan under S. 1527 would be significantly reduced.

The committee might also consider maintaining parity in the contribution levels to the two types of systems. A 1.3-percent retirement contribution for new hires combined with the Social Security contribution would maintain parity between the old and the new systems. This would also allow increased funds to be funneled into the defined benefit portion of the plan to increase benefits.

We also urge the committee to approve the survivor benefits under the plan. The costs of improving this aspect of the plan would be minimal, but it would provide peace of mind to all Federal employees.

In conclusion, S. 1527 is a significant first step toward the development of a supplemental retirement plan. We congratulate the Chair for his leadership on this issue. We look forward to working with the Chair and the committee in developing a supplemental retirement plan. We thank the committee once again for this opportunity to present our views and would attempt to answer any questions.

Senator STEVENS. Thank you very much. As I listen, I think basically, Mr. Peirce has some comments about the management of the thrift plan, which we will discuss.

But your comments, I think, could be categorized in three ways: One is that we really can't trust Congress not to tax the thrift plan. That may be true. It wouldn't tax this thrift plan without taxing all IRA's. As I just pointed out, this article indicates that we now have 34 million Americans participating in IRA's now, and 36.5 million indicated they planned to open one in the near future. In other words, within a small amount of time, we are going to have 100 million individual plans. That doesn't count the major employer plans.

I don't think that is a problem. Besides that, Mr. Murphy, our calculations of benefits do not derive from the nontaxability. They are derived from the contribution of the employer, which would still be there. Of course, that too would be subject to change by Congress, you are right there. I guess, depending on the economic situation, anything is subject to change by Congress.

My question would be this: Do all of you feel that the proposed COLA change, the OPI minus 2 provision is the most significant feature of the bill?

Mr. TOBIAS. Senator, what we look at in terms of trying to deal with the specific numbers, the 20.8-percent contribution as opposed to the 25 percent, what we would urge is——

Senator STEVENS. That is 3 percent, Mr. Tobias, in the COLA.

Mr. TOBIAS. That is correct, that is 3 percent. What we would urge is that the 1.3 percent be paid by the new employees; we would urge that 1.6 percent be saved from changing the thrift plan to 50 cents on the dollar match to a maximum of 6 percent, and that the FEGLI payment be eliminated. I don't know what the savings would be; vesting, beginning in the fifth year through the tenth year as opposed to the first year, would produce some savings but without that savings, the total would be 3.1 percent.

Now, allocating that 3.1 percent, we would urge that it be allocated in terms of the 55 versus 62, that it be allocated for improving the disability and survivor benefits and making a high 3 versus a high 5, and changing the accrual rate to 1.2 instead of 1. That would cost 4.2 percent.

Senator STEVENS. That is 1.3 and 5. There is 1.8. We are not too far apart on the total cost, I guess.

But if is based upon the fact that you are really saying that new employees should contribute the 8.3 percent.

Mr. TOBIAS. That is one factor, and then the second factor, the second big money item, would be to reduce the thrift plan to 50-percent contribution to a max of 6 percent. That is a 1.6-percent savings with that change. So that is where the big money savings is. For us, for our members, the No. 1 and I guess No. 2 priorities are the 55 versus 62, and the high 3 versus the high 5.

In terms of the COLA, we want to do some more work on it. We believe that the thrift plan will help offset the COLA reductions.

Senator STEVENS. We have a 0.9 cost with a difference between high 3 and high 5.

Mr. TOBIAS. That is correct. If it is 55 to 62, that is 0.5. The disability is 0.2. High 3 versus high 5 is 0.9; survivor benefits is 0.3, and changing the accrual rate from 1 to 1.2 is 2.3 percent. Add that up, and you get 4.2 percent.

Senator STEVENS. It is a difference in philosophy, I think. I understand where you are coming from. In my judgment, we are dealing with new, young employees. The votes that they are casting in the private sector are for the thrift accounts, and I think the Government ought to be where they are, not where we have been, but where they are.

Mr. TOBIAS. That is why we are not urging the elimination of the thrift plan or we are urging the thrift plan be part of this program. I think it is wise to be part of this program. We share this part of the thrift plan.

I think that the difference that we are talking about is really a difference in whether we believe that people can actually put aside 10 percent of their salary. What we are saying is 6 percent of their salary is more a realistic amount of money that someone can be expected to be putting aside in addition to the 8.3 percent.

If the Government is matching 50 percent of that, that is a 9 percent thrift plan, which is a pretty significant thrift plan. So we are not urging that it be eliminated, only that it be reduced in order to give us some of these other important benefits.

Senator STEVENS. What if we give them the option to reduce it? What would all of you have to say about that? What if we give them the option and say: You can make a 7-percent contribution and go our way, or you can make the 8.3 contribution and go your way? Does it have to be one single plan for all employees?

Mr. TOBIAS. My answer to that question would be I don't mind an option, but I think that what we are suggesting is a little more complex than that, because I don't know whether you can give people an option, high 3 versus high 5.

Senator STEVENS. No; no, we can't do that.

Mr. TOBIAS. Right. Everybody has got to be under the same plan. If you are saying to me, well, we can have high 3, we can have 55, and all we are going to do is give people the option of having the 1.3 and a thrift plan or 1.3 for larger benefits down the road, we would have no objection to that.

Senator STEVENS. Sixty-four percent of the employees of the United States are under a high-5 average—not a high 3, but a high 5. That currently includes the Government. I really think we are flying uphill on that one.

If we are really looking at a situation where people are demanding that we make this more comparable to the private sector, I think the high 5 costs the Federal employee less than a lot of the other options in terms of getting in line with the private sector.

Mr. TOBIAS. I think that Federal employees, new employees, old employees, every employee would be much more pleased, Senator, to go with a high 5 if they had a 20-percent pay increase. We are not talking about comparability in the private sector in terms of pay.

So realistically we are not.

Senator STEVENS. I make that argument every year, but it doesn't do me any good.

Mr. TOBIAS. It is still fact. It is still fact.

Senator STEVENS. It is a fact, but the problem is in terms of this system. The option that I was talking about was the option of taking the 1.3 and putting it in the thrift plan; or taking the 1.3 and putting it in the defined benefit; or taking the 1.3 and putting it into the option of buying, in effect, insurance for the 55 and 30 retirement and being equivalent to having Social Security for the 7-year period or whatever it might be, so that when persons retired early at 55, they would get their Social Security comparability before they started getting Social Security. In other words, insurance to fill the gap would be about 1.3.

You could have a comparability system so that you could elect, when you went in, what you were going to get out in 30 years, and if you wanted to retire at 55 with full Social Security at 55, you could use that 1.3 and accomplish that. It is not a bad option, but it ought to be an option, because a lot of people are going to say, "I am going to get promotions, and I would much rather take the thrift route."

The option ought to be, in my judgment, between the thrift plan and the security factor of the 30 and 55 plus insurance to provide that Social Security equivalent during the period before you are eligible for Social Security. We can do that. I think that option is a viable option.

Mr. TOBIAS. I would like to suggest that if you take the 1.3 percent, rather than making a formula of the options as you suggest, perhaps what we could do is take the 1.3 percent and make that option in terms of the amount of the accrual rate: Instead of 1 percent, 1.2 percent, and if we generated another 1.6-percent savings from reducing the thrift plan to from 50 percent to 60 percent, we could give Federal employees both the 55 with 30 and the high 3 versus the high 5, and still have two-tenths of 1 percent left over to apply to something else.

Senator STEVENS. You and I ought to visit about this. I want the others to comment on this too. The witnesses appearing before you have fairly well convinced me that we ought to have one accrual rate for the first, say, 10 or 15 years and a higher accrual rate for the last portion, and there is a compensating balance there.

Eventually, the system works out the same, don't you understand? It just costs more in later years as compared to the earlier years. But over a 20- or 30-year period, it would cost the same.

Mr. TOBIAS. Because people leave.

Senator STEVENS. That is right.

Do any other people have any comments about our dialog, Mr. Peirce, Mr. Murphy?

Mr. PEIRCE. I think there is a combination there where we can accomplish what we are saying.

Senator STEVENS. I believe, Jim, there is a lot of flexibility here, a lot more than our bill indicates in the beginning, but we had to have these hearings.

Mr. MURPHY. Senator, one comment I want to raise, and I guess it is more in the form of a question, you cited throughout the hearings some statistics about the number of low-income families who are involved with IRA retirement plans. I would be very interested in seeing those statistics.

I would—from my own experience and the experience of our union—we would have reservations about it. We wonder if those statistics don't represent perhaps members from the professional, technical, administrative grade and types of employment rather than blue collar, skilled and unskilled, and low graded blue collar.

Senator STEVENS. This was a newsletter given to us by the USAA Life Insurance Co. referring to a Sindlinger & Co. survey, and to a survey which was apparently sponsored by the Heritage Foundation. This company is in Wallingford, PA. I don't have the survey, but I have asked to get a copy.

Mr. MURPHY. The other point on that, Senator, that I would just like to make is that I think there are a number of families who might be able to participate in an IRA type of arrangement during the early years in a marriage, but when one spouse leaves in order to have a family, that may no longer be an option. The statistics may show they have an IRA, but they had it, in fact, 4 years out of maybe 25.

Senator STEVENS. Let me tell you, the figures we had from Prudential indicated that for the participants who had less than $15,000 in income, 74 percent of them were participating in an IRA, 74 percent, and those who were participating who earned less than $15,000 were participating to the extent of 7 percent of their savings. I think that the support for the IRA in the lower incomes is greater than we believe.

Mind you, it is true that those who are in the higher income brackets support it even more, but the IRA has become probably one of the most sought-after mechanisms for deferring income for low- and high-income people. I think it ought to be part of this system for Government employees.

But the kicker is the matching. That is where the money is. I think that is where Mr. Tobias and I might have disagreement.

Let me yield to Senator Gore, because I am sure he has some questions. I have been asking too many.

Senator GORE. No, no, Mr. Chairman. I have enjoyed the interchange. I think it is very interesting and illuminating. I think this panel of witnesses is candidly addressing some of the hard choices that have to be made.

Do you all three agree with the political assumption that there is no point in considering a plan more expensive than the one that now exists?

Mr. TOBIAS. I certainly agree that that is true, that there can be a plan that is more expensive, and I also agree that we are not going to have a plan by January 1986 that is equally as expensive. I think that is a fact, as well. If I believed that, I wouldn't be engaging in dialogue with Senator Stevens about generating savings and how to get what it is that we want.

Senator GORE. I appreciate that.

Mr. TOBIAS. Candidly.

Senator GORE. That is right. And you both also agree?

Mr. MURPHY. I think, Senator, our goal from our perspective from the beginning has not been to develop a retirement plan that has been more expensive than the current, but rather one that would provide comparable levels of benefits at comparable costs.

We think it will create a lot of disharmony in the work force if the employees are seeing lesser benefits.

For instance, one group of employees who are hired 1 year earlier are entitled, 30 years from now, to retire, whereas those that were hired maybe a year later can get out after or will have to wait maybe 35 years. We think that is going to cause real problems down the road. That is why overall, we are looking for a comparable plan.

Senator GORE. I personally would support a comparable plan. I understand the problems in comparing the total compensation package with counterparts in the private sector, and I would support it.

But I am keenly aware of the political environment. I respect the assumptions made by the chairman, and I also strongly believe that we need a bill this year. So how do we get there? You have explored many of the tradeoffs with the chairman, and I will not go back over that ground.

Let me just ask you a few questions of my own. All three of you support both early retirement and full indexing for inflation. I wonder what your reaction is to the idea of a so-called diet COLA provision, which would provide for only reduced inflation protection for those employees who retire early.

Mr. TOBIAS. I don't know that there is a connection between reduced inflation protection for those who retire early. I think that the bill as presently drafted provides for reduced inflation protection for anyone who retires.

Senator GORE. I know. I am asking for your reaction to this idea.

Mr. TOBIAS. I see. Well, as I said to Senator Stevens, I don't like it. In the mix of putting together a bill, I think that there are other things that are more important. I think that retiring at age 55 and I think that high 3 versus high 5 are more important items. What I was trying to do was to describe a scene where that would be possible and still meet, or come very, very close to that 20.8 percent.

Senator GORE. But I am trying to pose a hypothetical choice for you. One choice is reduced COLA across the board, but the same reduction in COLA for everyone, with reduced benefits starting off for those who retired early.

The other option is full COLA, except for a reduction in the COLA for those who retire early.

Mr. TOBIAS. The COLA cost is 3 percent. To restore full COLA's would cost an additional 3 percent. What I have been suggesting here is that we can generate 3.1, an additional 3.1 percent, by decreasing the Government's contribution to the thrift plan, that is 1.6 percent; increasing the employee's contribution, 1.3 percent; eliminating FEGLI. That is 3.1 percent additional moneys, 3.1 percent.

Then instead of using that money to take care of the COLA, what I am suggesting is that what would happen is that it go to 55, high 3 versus high 5, disability survivor and increasing the rate from 1 to 1.2. So we would forgo the COLA if we could get these other things.

Senator GORE. Yes, OK. Well, I understand. I want to ask the other two witnesses to address this question. A full COLA would cost an additional 3 percent of payroll. A diet COLA would cost an additional 2.5 percent. You understand the hypothetical choice. You have got a proposal that has CPI minus 2 for everyone and reduced base benefits for those who retire early.

Another option would be to have the early retirement disincentive occur in the form of an adjustment to the COLA. Do you see what I am saying? So that you get a full COLA, unless you retired early, and then if you did retire early, you would get the reduced COLA formula instead of the reduction in base benefits.

Mr. PEIRCE. I don't know that there is any choice in it. I would stick with the full COLA, but I think the solution is a mix of these to the extent that we can spread the benefits to where they are more comparable with the current system. That is the only real move that I see.

Senator GORE. Yes.

Mr. MURPHY. Senator, I am not sure that the savings you would realize in that change would be worth some of the negative results that would happen. I think there is a percentage of the work force that, for instance, has to retire at less than age 62. In addition, there is a percentage of the work force, for physical or health reasons, who have to get out at age 55.

Senator GORE. Your first category is pretty small, isn't it?

Mr. MURPHY. I would suspect, yes.

Senator GORE. Very small.

Mr. MURPHY. In addition, it is one of the most attractive features of the plan, there is no doubt about it. The opportunity for retirement at 55 after 30 years encourages loyalty and long service. So for the 0.5 in savings, I am not sure it would be worth it.

Senator GORE. I appreciate your reaction, and please understand that it is not my preference. As an idea, it does seem to have some merit in addressing two problems simultaneously: One, you save some money, and you are able to say that COLA's have been affected.

Two, you achieve some early retirement disincentive, which may also be a necessity for getting a bill this year. So think about it, and my staff and I will be discussing this with you and others as a potential change.

Senator Eagleton has asked a number of witnesses and would ask you, were he here, about the level contribution issue. I think a couple of you addressed this previously, but just to get the question from Senator Eagleton on the record and your response—is it your position that new employees should have to contribute the same percent of their pay for retirement as the old employees? That is, should there be level contributions between the old and new retirement programs?

Mr. PEIRCE. I think my answer to that is as long as we have got comparable benefits, it seems like we should have comparable or parity of contributions.

Mr. TOBIAS. Yes, I agree with that.

Mr. MURPHY. It would be unanimous, Senator.

Senator GORE. If we did have level contributions, would you object to a requirement that such contributions be made to the thrift plan rather than to the defined benefit plan?

Mr. PEIRCE. Yes; I don't think the thrift plan is the place for it because, No. 1, to me, that doesn't do anything for parity.

Mr. Tobias. Yes. I would object to that. I think that it is much too rigid an approach. I think we have to look at the total package, and the total benefits, and consider it in that context, not just whether we are going to apply that 1.3 percent to the thrift plan and mandate that it be included as part of the thrift plan.

Mr. Murphy. Senator, our position on the bill was that we were looking to increase the generosity or the value of the defined benefit portion of the plan, and we thought that some savings could be realized through the thrift plan. So we support taking that 1.3 and putting it in the defined benefit portion.

Senator Gore. OK. Maybe Senator Eagleton will want to pursue this. I think that there could be parity, that there wouldn't be identical twins, but you might achieve parity that way.

As I said earlier, Senator Stevens has explored many of the issues that I was prepared to deal with, and as a result, I will submit any additional questions in writing.

I certainly appreciate the chance to talk with you.

Mr. Tobias. Thank you.

Senator Gore. Mr. Chairman.

Senator Stevens. Thank you very much.

Thank you very much, gentlemen. Mr. Tobias, I think you have made a great contribution. I think we will be back to you with some options. I tell you, we do it in life insurance; we do it in health insurance. I see no reason why the educated group we are dealing with cannot look at, say, two or three options on retirement and decide which one fits their career pattern. We ought to devise those options. If we do it, I think we will remove a lot of the current misunderstanding of what we are trying to do.

I look forward to working with you.

Mr. Tobias. Thank you, Senator.

Mr. Murphy. Thank you, Senator.

[The prepared statements of Messrs. Peirce, Tobias, and Murphy follow:]

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THE NATIONAL FEDERATION OF FEDERAL EMPLOYEES

BEFORE

THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

THE CIVIL SERVICE PENSION REFORM ACT

S.1527

SEPTEMBER 9, 1985

Mr. Chairman and Subcommittee Members:

I appreciate the opportunity to testify today on S. 1527, a bill which Senator Stevens and Chairman Roth have introduced to establish a new retirement system for Federal employees hired after 1983. The National Federation of Federal Employees represents a substantial number of employees who are contributing to the current Civil Service Retirement System (CSRS) as well as employees who will eventually retire under the new supplemental system. We are therefore extremely concerned about the ability of the new retirement plan to provide a secure retirement for future Federal retirees.

S. 1527, the Civil Service Pension Reform Act of 1985, represents a good start toward designing a retirement system, and I commend the sponsors for your efforts to develop the plan before the January 1, 1986 deadline. The bill recognizes that a retirement annuity is the most important job benefit for both workers and management -- a consideration which is especially important in the Federal government. Civil service retirement is probably the only major benefit earned by civil servants which compares favorably with similar programs in the private sector. In fact, with pay rates and total compensation so low in comparison to the private sector, retirement is one of the few remaining incentives to stay in the Federal workforce. As such, it is the cornerstone of the Federal compensation system. It is the primary incentive for individuals to enter Goverment service and to pursue Government careers.

Throughout the discussion of the new supplemental retirement plan, NFFE has urged Congress to develop a system which would provide a level of benefits comparable to the current program. It would be a disaster to create a new program that did not continue to protect the government's expertise and institutional knowledge. NFFE has also stressed that cost savings should not be the primary factor in establishing a new system -- the last thing we want is a cheap retirement plan. The modification of three of the most essential elements of the current CSRS, which S.1527 proposes, is therefore a cause of great concern. The benefits to which I refer are early-retirement, cost-of-living adjustments and the High-3 benefit calculation: all of which are valuable components of the current Federal annuity package.

The current Civil Service Retirement System permits an unreduced retirement benefit for an employee at age 55 with 30 years service, age 60 with 20 years service, and age 62 with 5 years service. The new bill, however, would permit an unreduced benefit only for employees at age 62 with at least 5 years service. Workers could choose to retire at age 55 with 30 years of service, but the benefit would be reduced by two percent for each year under age 62 an employee retires. Participants could also choose to retire at age 55 with less than 30 years of service but more than 10 years, with benefits reduced by five percent for each year under age 62.

The early retirement option, which has long been available to current Federal employees, is perhaps one of the most-valued retirement benefits civil servants believe they have under the current system. Changing this option would not only be unfair to post-1983 employees, but it would also be unnecessary. By penalizing these employees for retiring before age 62, S. 1527 would create two separate systems of age and service requirements. New employees should have the same retirement options as current Federal employees.

Despite charges that this benefit is too liberal, the current age and service requirements have resulted in an average Federal employee retirement age that is close to the average in private industry. According to the General Accounting Office, civil servants retire at an average age of 61.1 with 29 years of service; private sector employees retire on the average age of 61.8. And the cost to the retirement system is hardly significant. In fact, continuing the same age and service requirements under the new supplemental plan would add only .5 percent to the cost of the new system. In light of the value of the early retirement option for Federal employees, .5 percent is a small price to pay to retain highly qualified employees, and I urge the Committee to restore this option.

I am also concerned about the reduction in the cost-of-living adjustment (COLA) for retirees proposed by S. 1527. The current

CSRS provides for a full COLA. The supplemental retirement bill, however, would reduce the annual COLA to the rate of the Consumer Price Index (CPI) minus two percentage points. This reduction violates the most fundamental principle of a staff retirement system - to protect retirees from a loss in the value of their benefit payments. On the basis of equity alone, the supplemental retirement plan should provide a full COLA in order to retain the current system's commitment to the future financial security of retirees.

Finally, the new supplemental retirement system would modify the recent method of calculating benefits based on the salary base. The salary base for calculating the retirement annuity is derived from the average of the three highest years of service. Under S. 1527, the salary base would be determined from an average of the five highest years, thus lowering an employee's salary base considerably. Combined with the reduction in the COLA and the penalties for retiring at age 55 or age 60, the change from High-3 to High-5 would severely reduce benefits. With pay rates and total compensation so low in comparison to the private sector, retirement is one of the few remaining incentives to stay in the Federal workforce. Should civil service retirement also fall below private sector standards, the Government would find it virtually impossible to recruit and retain talented employees.

These changes over the CSRS not only threaten future retirees (hired after 1983) whose benefits would be significantly reduced, they also set a dangerous precedent for the current system. Provisions such as these could easily put pressure on the current CSRS for similar changes. I therefore urge the Committee to consider carefully the damaging effect on both annuities and employee morale such reductions would have. The cost of restoring these benefits would surely be small in comparison to the resulting increased morale and productivity.

I would now like to address the thrift portion of the new supplemental retirement plan which, aside from social security coverage, is the most significant change from the current system. While the concept of a thrift plan has merit, there are inherent difficulties in both its application and administration. In addition, the plan does not give the employee significant control over the management of his or her account.

S. 1527 establishes a thrift plan into which employees may contribute up to 10 percent of their salary with a maximum employer matching contribution of 5 percent. (The contributions would not be included in gross income for tax purposes before the account is paid out.) Under the new plan, the employee/employer contributions would be absorbed into only three investment options: (1) a Government Securities Investment Fund which is invested in special issues of the Treasury, (2) a Fixed Income Investment Fund which is invested in insurance contracts, certificates of deposit, or other instruments, and (3) a Common Stock Investment Fund which is invested in common stock issues included in a commonly recognized stock index. These accounts would be administered by a Thrift Investment Board with the assistance of a Civil Service Thrift Advisory Committee.

The thrift plan, as it is now envisioned, leaves me with four immediate concerns. They are: the effective management of potentially vast sums of money in the thrift plan and their impact on the economy; the creation of a new government entity with appointed individuals who more than likely do not have the necessary expertise to administer the thrift plan funds; the strong, economic power base such individuals would hold; and finally, the restriction of an employee's fundamental right to choose where his or her contributions should go.

As more and more employees join the Federal workforce and participate in the thrift plan, a huge sum of money will be available for investment. In fact, the fund will be the largest single employer-thrift plan in the world and as such will have a significant impact on the economy. As the funds accrue, they could increase to such monumental proportions as to be completely unwieldy and possibly, economically threatening. According to our estimations, the thrift plan could accumulate $998,910,968,217.14, or $1 trillion over a forty year period. Even the most conservative estimates show that approximately one half of a trillion dollars would be amassed.

Without a doubt, this vast sum of money could have a significant impact on the business world. While it is true that private pension funds now hold approximately $1.3 trillion and absorb one hundred billion dollars a year, these funds are held by individual pension funds. There is no single board which decides how these private pension funds are invested. S. 1527, however, would create a board which would be making decisions controlling almost one trillion dollars. As you can imagine, the potential economic power the Civil Service Pension System thrift plan managers would have would be enormous. My concern lies in the ability to ensure adequate protection against financial manipulation by the thrift plan administrators. I am not yet confident that these protections can be made strong enough.

The size of the government entity required to actually administer the thrift plan would have to be enormous to properly manage and invest such a large fund. I do not believe that, as S. 1527 is currently written, either the investment board or advisory committee can adequately meet this responsibility. Not only would it be difficult to attract the high caliber employees needed to fulfill this mandate, but appointed individuals, with little or no investment experience would make the final decisions. I am not confident that the best decisions would be made.

Finally the thrift plan fails to give employees adequate control over their thrift account. Although the thrift plan provides employees with vehicles by which to invest their funds, it takes away their independence to make such decisions for themselves. The plan, therefore, cannot be considered an adequate investment mechanism. I firmly believe that any new Federal thrift plan must enable, even encourage, employees to make their own investment decisions which will suit their individual needs. You would do a great injustice to civil servants by underestimating and limiting their ability to determine their own retirement investments. The Federal workforce is better educated and more professional than at any other time in its history. It is essential, then, that its employees should be given the right to control their own retirement future.

The Committee could grant this right by amending Title I of the Civil Service Pension Reform Act of 1985 to allow employees to designate where their funds will go. This approach would permit employees to designate the thrift retirement account of their choice provided the account satisfies requirements similar to those required for individual retirement accounts. This would eliminate the need for a new government entity that would have invested the monies into government established accounts. Since the contributions will be placed into individual thrift accounts, no Federal body would be necessary to make investment decisions. Authority to promulgate regulations to implement and manage the programs could be given to the Internal Revenue Service or another Federal agency.

The employee could specify the amount to be deducted (by the employing agency) from the employee's paycheck. The employee and matching employer contributions could in turn be electronically transferred and deposited into a thrift plan account of the employee's choosing. Such designations could be changed, without restriction, at the employee's request. As provided by S. 1527, all contributions would be made on a tax-deferred basis and the employee would be charged no administrative fee.

The design of a retirement system that encompasses both a defined benefit, defined contribution and social security system is a formidable task. I must therefore commend both the Chairman and Senator Stevens for undertaking this task and for moving the new supplemental retirement system from discussion toward implementation. I hope the Committee will consider NFFE's concerns and suggestions and continue to work with us to develop a secure retirement system for future retirees.

That concludes my statement. I will be happy to answer any questions you may have.

NTEU
The National Treasury Employees Union

STATEMENT OF

ROBERT M. TOBIAS
NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION

TO THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

HONORABLE WILLIAM V. ROTH, JR.
CHAIRMAN

CIVIL SERVICE PENSION REFORM
ACT OF 1985 (S.1527)

U.S. SENATE
WASHINGTON, D.C.
September 9, 1985

Mr. Chairman, Members of the Committee, I am Robert M. Tobias, President of the National Treasury Employees Union. The National Treasury Employees Union is the exclusive representative of over 120,000 Federal employees in a variety of departments and agencies.

We appreciate this opportunity to testify on S. 1527 which represents the most concrete proposal to date to deal with a Civil Service Retirement Plan for Federal employees who become covered by social security as a result of the Social Security Amendments of 1983.

I first want to commend the Chairman and members of the Committee for the professional, intelligent and prudent manner in which you have approached this complex and difficult task. The research, studies, and legislative drafting work completed by this committee stand in sharp contrast to the haphazard myopic manner in which this Administration has tried to advance changes in the current civil service retirement system, make proposals for this retirement plan and propose changes in other areas involving the pay, benefits and working conditions of Federal employees. Throughout this administration, matters concerning the pay and benefits of Federal employees have been discussed, opinions formed and decisions reached in politically charged forums. Fast action and expedient measures designed to help alleviate budget problems have taken precedence over a more rational approach to substantive change in these areas.

In the short time remaining in this session of the Congress to consider S. 1527, we hope the consideration and debate necessary to shape this retirement plan will continue to focus on the substance of this complex subject and not become a political numbers game with dollars for deficit reduction becoming the sole determinate of what this retirement plan will be. We will eagerly work with the committee first to ensure that a retirement plan is enacted before January, 1986, and second that the plan enacted is fair, equitable and rationale.

In considering this complex legislation, we strongly believe that certain goals and objectives should be established.

Should our goal for retirement be one of enabling those in retirement to maintain their preretirement standard of living; merely meet basic needs; or something in between? We believe the goal should be that of maintaining their preretirement standard of living.

The President's Commission on Pension Salary in 1981 estimated that the average income replacement that is needed to maintain a preretirement standard of living for a single person ranged from 79 percent for the minimum wage earned to 51 percent for the highest income person. The range for married couples was 86 percent to 55 percent.

Social Security does not provide sufficient income at any level to maintain preretirement living standards. It is not intended to. As a social insurance program, its goal is to provide a floor of income protection.

The employer's-- in this case the Government-retirement program is crucial if adequate income is to be provided for maintaining a reasonable standard of living in retirement.

Coupled with the goal of maintaining a preretirement standard of living, we also believe that retirement benefits should be formally recognized as deferred compensation, earned by the employee during their working career. The objective should be to provide legal recognition of this and guarantee that the benefits provided and promised at the time of employment will not be subsequently taken away. This point is particularly noteworthy as one of the purposes of S. 1527 is ". . .to provide Federal employees with a retirement benefits plan which is comparable to good private sector retirement benefits plans . . ." (emphasis added). Federal employees are understandably skeptical of such a Congressional statement of purpose if in reality their retirement benefits plan will be subject to the same whimiscal, petty pick-pocket ploy this Administration has seen fit to inflict on the Government's pay system. Abandonment of the pay comparability principle and not guaranteeing a level of retirement benefits at the time of employment will have a devasting long-range negative impact on the recruitment and retention of a competent, professionally responsible workforce.

We believe that another objective of the Government's retirement plan should be to provide benefits that will attract and retain quality employees thereby providing the incentive for the development of a well trained, highly competent and dedicated career service. Anything short of this objective will only encourage mobility and a high rate of turnover with disastrous results.

S. 1527 provides the basic elements for a sound, effective retirement benefits plan; however, there are some basic provisions that we believe need to be considered in order to assure a sound retirement policy and be equitable with the current retirement system for Federal employees.

The new plan should, in conjunction with Social Security, provide a level of benefits as close as possible to those under the present system. The level of benefits under S.1527 would be substantially different than those received by employees covered under the current system. The defined benefit plan plus social security will provide benefits that, depending on salary, will be 5% to 34% less than the current system. For retirement at age 55 with 30 years service, the benefits will be 57% less than the current system. Even at age 60 with 30 years service; the benefits will be from 3% to 9% less than the current system. Under the proposed plan, employees would have to participate in the capital accumulation plan in order to meet minimum adequate income replacement and security needs. We believe that the benefits from a capital accumulation plan should be at the employee's option to increase their retirement standard of living or for other purposes and not be calculated as part of what is necessary to maintain retirement income security. Those who cannot afford or do not want to participate in a thrift plan should not be penalized. I should also note on this point that present income tax advantage and future retirement income security cannot be presumed by those who participate in the thrift plan if this Administration continues to push for and is successful in striking down the tax status of these deferred income plans.

The new plan should also provide for an unreduced benefit at age 55 with 30 or more years of service. A reduction of 2% for each year under age 62 flies in the face of sound personnel management and recent trends in private sector employment. It also creates an intolerable situation of two employees working side by side doing similar kinds of work yet receiving vastly different benefits. Retirement with dignity and security after 30 years of service is justly deserved and indeed should be encouraged to maintain a workforce.

The defined benefit plan in S. 1527 provides benefits based on years of service and salary and would merely be added to the Social Security benefits. As an "add-on" plan, it ignores the effect of the "tilt" in Social Security benefiting lower wage earners and shorter career workers. For example, the basic pension plus Social Security for an employee at age 62 with 30 years service and a final salary of $15,000 would replace 50% of salary, if the final salary is $45,000 it would replace only 40% of salary. "Offset" and "step rate" methods of integration with Social Security are found most commonly in the private sector to balance the "tilt". The step rate method formula is designed in a way that a different percentage would be applied to various levels of pay. A given percent would apply to pay up to a certain amount and a higher percent to pay above that amount. ERISA and IRS regulations do not permit private sector plans to completely offset Social Security benefits. While the regulations are not applicable to the Federal Government, we believe that as a matter of public policy they should be followed in the designs of this new plan. Thus, only half of the Social Security "tilt" could be offset. This still would leave a difference in income replacement rates between the lower paid and higher paid employees. However, these differences would only be about half the level they would be under the add-on method presently in S.1527.

There are two other basic issues in S.1527 that require serious consideration before an overall plan can be fully considered: the salary base used to compute benefits, and protection of retirement income from inflation.

First, we believe that the proposed computation rate of one percent per year of service based on the high-5 average salary produces a benefit that is equitable only for an employee making less than $20,000 a year. Employees earning more will have considerably less salary replacement. A slightly higher accrual rate based on the present high-3 average salary will be more equitable particularly for employees earning in the $20,000 to $30,000 salary range.

Second, we believe that the COLA policy should automatically follow whatever policy Congress sets for Social

Security. Reducing each CPI increase by 2% as proposed by S.1527 merely compounds the erosion of the purchasing power of the annuity the longer the annuitant receives benefits. And it will become more difficult to maintain a level standard of living.

Finally, Mr. Chairman we would like to comment specifically on the proposed new sections 8401(17) and 8411(c) relating to retirement of law enforcement officers and firefighters.

The development of a new retirement plan provides an opportunity for Congress to clarify and correct certain problems and inconsistencies that exist in the current law and at the same time, provide for similar treatment of employees engaged in similar work under the new law.

The provision concerning coverage of law enforcement officers was initially enacted in 1947. It was primarily written to cover FBI agents. It was amended five times between 1947 and 1974 to cover certain other occupational groups.

As a result, the broad occupations category of the position occupied became paramount rather than the actual requirements and duties of the positions occupied.

The duties and responsibilities of both customs inspectors and IRS revenue officers more than meet the criteria established for coverage under the special provisions for law enforcement officers coverage.

However, because of one word in the current law, they have been denied these benefits. Their positions are not considered as primarily the investigation, apprehension, or detention of individuals suspected or convicted of offenses against criminal laws of the United States.

Yet by every other measure, these positions require the same degree of law enforcement background and exposure to hazards as other policy type functions which do qualify.

Customs inspectors today, for instance, are making an increasing number of arrests and are not allowed to perform inspector duties until qualified in firearms. Kidnaping, murder, and assaults are an ever-present danger in both professions.

More and more Customs inspectors are working on special enforcement teams doing undercover investigatory work with special agents, Drug Enforcement Agency personnel and local law enforcement groups to stop the increasing flow of drugs into this county.

Similarly, IRS revenue officers are exposed to an ever increasing number of life-threatening situations in the course of their normal duties. Assaults against IRS employees increased from 531 in 1983 to 789 in 1984, a 50-percent increase.

In addition to these incidents, there are several well-financed groups around the country who advocate organized violence against IRS employees. Excluding these organizational categories is not only unfair to this group of employees but prevents the Government as employer from maintaining a young and vigorous work force in this vital area of law enforcement.

In summary, Mr. Chairman, there are several issues to consider before this new retirement plan can be enacted. S.1527 provides a solid basis and a conceptually sound framework within which I believe we can work to enact a retirement plan this year. We will do all we can in working with you to enact a plan that is fair and equitable to Federal employees and the government for which they work.

I will be happy to answer any questions you may have.

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TESTIMONY OF THE

NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

TO THE

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

ON THE

CIVIL SERVICE PENSION REFORM ACT

S-1527

September 9, 1985

The National Association of Government Employees which is an affiliate of the Service Employees International Union AFL-CIO is pleased to have this opportunity to present our views on S 1527, the Civil Service Pension Reform Act.

The design of a retirement system for employees covered under Social Security is a task of historical importance to the Civil Service. The Civil Service Retirement System has been government's most important tool for the recruitment and retention of quality employees. With federal pay and other benefits lagging far behind that commonly recieved in the private sector, it is more important than ever that the pension system available to new hire federal employees be a quality one, comparable to the current CSRS. The task facing the Congress in developing such a plan is an extremely complex one requiring mature leadership from all quarters.

The Civil Service Pension Reform Act S-1527 is an important first step towards the development of a supplemental retirement plan which will be fair to federal employees, taxpayers and consistent with the traditional goals and objectives of the Civil Service Retirement System. The Chairman is to be applauded for taking these crucial first steps towards the development of a supplemental retirement plan.

The Civil Service Pension Reform Act is structured on three tiers composed of Social Security, a defined benefit, or basic pension plan, and a thrift savings plan.

SOCIAL SECURITY

The first tier under S-1527 is Social Security. Employees would contribute to Social Security and recieve it's benefits in accordance with applicable law and regulations. Currently the tax rate for OASDI is 5.7% in 1985, increasing to 6.06% in 1988, and 6.20% beginning in 1990. Employees contribute up to the maximum taxable wage level, which currently is $39,600. Benefits under this portion of S-1527 are determined in accordance with applicable Social Security law. While space doesn't permit documentation of that formula, it is significant to note that social security is in part a social insurance program which redistributes wealth from the high to the low income worker. Thus, for instance, under Social Security if an employee worked 30 years and earned $15,000 annually he would recieve roughly $6,000 in benefits, while an employee earning $30,000 annually during the same period would earn $8200 in benefits, while an employee earning $45,000 would recieve $8400. A basic decision in designing a pension plan is whether or not to offset the social security tilt. Stevens / Roth is a social security add on plan which does not offset social security.

DEFINED BENEFIT

The second tier to S-1527 is the defined benefit or basic pension plan. The formula under Stevens / Roth for determining benefits would be based on 1.0 percent of the average of workers highest five consecutive years of wages for each year of service completed. By comparison the current CSRS formula is based on the high three years of salary multiplied by 1.5 times the first five years, 1.75 times years 5-10, and 2.0 for all years after 10.

Under Stevens / Roth retirement without penalty would be allowed at age 62. Employees would vest following five years in service. Employees retiring at age 55 with 30 years of service would have their benefits reduce by 2% for each year they are under the age of 62 at the time of retirement. This would constitute a 14% reduction in the annuity. Employees retiring at age 55 with less than 30 years of service would face a 5% per year reduction for every year under the age of 62. Thus an employee retiring at age 55 with 10 years of service would receive a 35% reduction in the annuity. Thus the bill provides substantial penalities for early retirement, one of the most popular features in the current system.

The bill also provides for early retirement for law enforcement officers, firefighters, and air traffic controllers after 25 years of service in the occupation. There would be no reduction in the annuity, and there are provisions to pay a supplemental annuity until the employee reaches age 62, and Social Security begins.

There are also provisions in the bill for an annuity at age 50 with 20 years of service and at any age with 25 years of service when an employee is involuntarily seperated. These annuities would be reduced by 2% per year under the age of 62. Deferred benefits would also be payable at age 62 for workers seperated with at least 5 years of service, or reduced benefits would be payable at age 55 with 10 years of service.

In the area of income protection after retirement, the Stevens / Roth bill provides substantially less protection than is provided under CSRS. Under S-1527 COLA's would be paid annually at 2 percentage points less than the rate of inflation as measured by the consumer price index. The CSRS of course allows for a full COLA adjustment based upon movement in the consumer price index.

The defined benefit plan would have no employee contributions, unlike the current system which requires a 7% contribution. Each federal agency would be required to contribute an amount equal to the normal cost of benefits for the agency's employees. The bill also requires a yearly determination of the Fund's supplemental liability amorized over 30 years. This contribution would come from the Treasury.

THRIFT PLAN

The third tier of the plan would create a voluntary tax deductable capital accumulation plan. Employees would be permitted to contribute up to 10% of their salaries to the plan. This contribution would be tax deductable. The first five percent of this contribution would be matched by the government. The capital accumulation plan would increase portability, and provide greater benfits to short term employees. There is currently no similiar plan under CSRS.

The employee is immediately invested in his own contribution to the thrift plan. The government's contribution is vested 20% a year with total vesting occuring after five years.

The employee may elect investment of his account in government securities, fixed income securities, or equities using an index fund invested in a diversifed common stock portfolio. There would be a gradual phase in of the private sector investment options.

The employee could receive a payout of the vested account balance, as an annuity, in cash at retirement, death, or disability or as a rollover to an IRA when the employee leaves employment. Hardship loans would be allowed to employees from their fund balance under certain limited circumstances.

SURVIVOR BENEFITS

Under Stevens / Roth the surviving spouse may get social security benefits, plus group life insurance, plus 50% of pension reduced for early retirement, and for election of joint and survivor annuity. In the instance where an individual is vested but not eligible to retire the pension to the survivor does not commence until the individual would have become eligible to retire. In addition as previously mentioned the survivor could immediately receive the thrift plan account. Under Stevens / Roth the Federal Government would assume the costs of group life insurance (FEGLI).

DISABILITY

Under Stevens / Roth a long term disability insurance plan would be administered by a third party. Employees would be eligible for disability benefits after 18 months of creditable service. If the employee was eligible for SSI he or she would receive 60% of the average high 5 salary, or 40% if not social security eligible. Benefits would be reduced by an amount equal to that received from social security. Benefits would continue until age 55 when the employee would receive an annuity in accordance with the benefit formula. Credit for years of service would be given during the period the employee is receiving long term disability for purposes of determining the basic pension formula.

COST

The cost of a pension plan is arguably the most important decision to be made in the shaping of a supplemental retirement plan. Under Stevens / Roth the total employer cost, according to data supplied by the Congressioal Research Service, is equal to 20.8% of payroll. The defined benefit portion of the plan accounts for 11.7% of the cost, Social Security 5.9%, thrift plan 3.0%. By comparison the current Civil Service Retirement System cost is approximately 24% payroll.

ANALYSIS

The S-1527 is a comprehensive piece of legislation which addresses the many complex issues involved in the design of a supplemental retirement system. It is an important first step towards the development of a fair and workable retirement system. The design of the bill has many positive features. The bill would significantly increase the portability of pension benefits through the addition of Social Security, and a thrift plan. The large numbers of employees who contribute to CSRS and receive no benefits or return has been a problem with the System for a long time, and we're pleased to see that problem addressed.

We endorse how S-1527 treats the social security tilt with an add on plan rather than an offset plan.The offset plans are more complex to administer since they require a determination of social security benefits. In addition the offset plans are more difficult for employees to understand and hence make retirement planning more difficult to undertake.

The utilization in the bill of the three tier system is a design which provides maximum flexibility to the pension system. The addition of the thrift plan is an effective means of addressing the social security tilt since a tax deferred savings plan would be of particular advantage to higher paid employees since they have more cash to participate in a thrift plan, and would also receive the greatest tax benefit. A thrift plan also gives greater portability to the retirement system. However, as we will discuss later in this testimony, while we regard a thrift plan as a useful tool in the design of a supplemental pension system, the defined benefit portion is in our view the central component of that system.

We also support provisions in the bill providing for employee involvement on the Thrift Board. This is a step towards restoring credibility to the system. There has been too much distortion as to the health and stability of federal employee retirement systems which has caused widespread confusion and a loss of confidence in the system. Employee involvement in managing the system should aid in arresting some of these distortions.

We also agree with provisions in the bill which have the existing fund serve both the current system and the new plan on an intergrated basis. This arrangement demonstrates a committment to continue the existing Civil Service Retirement Trust Fund on a stable foundation. It is crucial that retirees under the current system be assured that the Trust Fund will continue, on a strong financial basis.

While S-1527 is an important first step towards the development of a supplemental retirement system there are substantial improvements to be made before the bill is completed. The ultimate goal from our perspective is to develop a system which overall will provide comparable levels of benefits as the current system with the same level of contributions from the employee.

We believe that in order to develop a comparable plan to the current CSRS the cost of the plan is going to have to be roughly approximate. No amount of creativity will create a plan costing 20% of payroll which will provide equivalent benfits to a plan costing 24% of payroll.

While overall Stevens / Roth is 4% less expensive than the current CSRS, the defined benefit costs, including Social Security, are 17.6% of payroll or some 7.4% less than the defined benefit portion of CSRS. This from our perspective is the most significant deficiency in S-1527.

Much of the savings under Stevens / Roth is achieved through the proposed changes in the COLA (3.0%), early retirement penalties (.5%), change from the high 5 to a high 3 (.9%) and changes in the defined benefits accrual rate.

In any pension plan there are winners and losers or groups of employees who fare less well than other groups of employees. Under Stevens / Roth those who can take the fullest advantage of the thrift plan, and who need the increased portability provided by the system are the winners. The losers under this bill are those who seek an early retirement after long years of service with the government, and those who are unable to take advantage of the thrift plan.

To many federal employees the promise of a dignified, secure retirement at age 55 following 30 years of service, or at age 60 with 20 years of service has been the trade off for inferior pay and benefits. For many of the employees NAGE represents early retirement after long years of hard labor is not a luxury but rather a physical necessity. Under S-1527 this course of action would involve substantially increased risks to the employee and his family.

It has been argued that the thrift plan will provide a means for an employee to offset the effects of the early retirement penalty by long term investment and savings through the thrift plan. Those employees who are in the most physically demanding positions and in most need of early retirement are most often in the lower grades and unable to take advantage of the thrift plan. Under S-1527 early retirement might well become an option open only to the upper grades, and closed to those most in need ofthe opportunity. Those who would be most likely to take advantage of the thrift plan are the upper graded employees who are in the executive and administrative ranks.

An employee retiring with 30 years of service at age 55 would replace 53% of income at all levels under the current system. Under Stevens / Roth this employee if unable to use the thrift plan would replace only 23% of pay or less than half that received under the current system. Even if this employee was able to make full usage of the thrift plan he would only replace 38% of income at all levels. At age 62 when Social Security benefits become available this employee earning $15,000 who took full advantage of the thrift plan for 30 years would replace 57% of income, without any participation in the thrift plan only 42% would be replaced. For this same employee earning $30,000, 52% would be replaced with full usage of the thrift plan, but only 37% without the thrift plan. It is highly unlikely from our perspective that employees earning $15,000 to $30,000 will be able to set aside 10% of their pay for their retirement.

The full COLA provision in the current CSRS provides retirees on a fixed income with some measure of protection against the long term effects of inflation. Under S-1527 this protection would be significantly diluted by providing inflation protections at the rate of CPI-2. The employee earning $15,000 who retired at age 55 with 30 years of service would under S-1527 receive 51% of salary at age 80 with full usage of the thrift plan, without using the thrift plan this same employee would replace only 36% of income. If this same employee had earned $30,000 the replacement rate would be 46% with the thrift plan but only 31% without using the plan.

The NAGE and its members are committed to continuing the provisions which allow for a dignied, retirement at age 55, or 60 with no penalty following long years of service. We urge the Committee to remove the penalties for early retirement, and provide full COLA protections for employees.

While we support the three tier approach conceptually we have always regarded the defined benefit portion of the plan as it's cornerstone. Workers need the certainty and security which a defined benefit plan provides. Defined contribution plans while allowing for greater portability, shift the risk from the employer to the employee. Retirement income thus becomes as much a factor of investment return as length of service. An over reliance on the thrift plan for providing pension income as we believe exists in S-1527, will increase the turnover in government significantly.

The thrift plan in S-1527 is unusally generous. The dollar for dollar match on the employer's contribution is higher than is generally provided in the private sector. We suggest that a 50¢ on a dollar match is more consistent with the private sector practice. This provision would save some 1.6% which should be added to the defined benefit portion of the plan.

The S-1527 relies significantly on the favorable tax treatment provided to the thrift plan. With new tax reform proposals surfacing every day, an over reliance on the favorable tax treatment of the thrift plan is a risky enterprise. If the thrift plans such as the one in S-1527 were considered taxable by the Congress than the value of the plan under S-1527 would be significantly reduced.

We urge the Committee to place a greater reliance on the defined benefits portion and less on the thrift plan as a means of providing retirement income. This could be accomplished by improving the retirement benefit formula, and the salary base, and by reducing the amount of the employer's matching contribution.

The thrift plan provisions as was discussed earlier especially benefit higher paid employees in two ways; one, higher paid employees will be more likely to be in a position to save the money, and, two, since the contributions will be tax deductable the higner paid employees will recieve a greater benefit from the tax savings. In addition employees earning more than the social security wage base, currently $39,000,also receive a windfall of sorts since they will pay a less percentage of income to the retirement system than other groups of federal employees. Under the terms of S-1527 new hire federal employees will pay social security taxes only up to $39,000 with amounts in excess of that figure not taxed. By comparison employees in CSRS contribute on every dollar earned. For consistency sake the Committee might also consider requiring the full contrubution for new hire employees on amounts in excess of the Social Security taxable wage base. This would generate income which could be set aside for the defined benefit portion of the plan.

The Committee might also consider maintaining parity in the contribution levels to the two retirement systems. A 1.3%

retirement contribution, for new hires combined with the Social Security contribution would maintain parity between the old and new systems. This would also allow increased funds to be funnelled into the defined benefit portion of the plan to increase benefits.

We would urge the Committee to improve the survivor benefits under the plan. The current provisions for surviving spouses of individuals who died before retirement eligibility could cause severe financial hardship. The costs of improving this aspect of the plan would be minimal, but it provide peace of mind to all federal employees.

In conclusion S-1527 is a significant first step towards the development of a supplemental retirement plan. We congratulate the Chair for his leadership on this issue. The NAGE looks forward to working with the Chair, and the Committee in develop a supplemental retirement plan. We thank the Committee once again for this opportunity to present our views and would attempt to answer any questions.

Senator STEVENS. I believe that is the end of our witnesses for today. We will resume tomorrow morning in this room at 10 o'clock.

Senator GORE. It is hard to believe we are through.

Senator STEVENS. Senator Eagleton did just one heck of a good job. Thank you.

[Whereupon, at 3:16 p.m. the committee was recessed to reconvene at 10 a.m. the following day.]

CIVIL SERVICE PENSION REFORM ACT OF 1985

WEDNESDAY, SEPTEMBER 11, 1985

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The committee met, at 10:05 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Ted Stevens presiding.

Present: Senators Stevens, Eagleton, and Glenn.

Senator STEVENS. Good morning.

Our first witness is Lud Andolsek, president of the National Association of Retired Federal Employees. He is accompanied by Tom Trabucco and James Storey.

Good morning.

Mr. ANDOLSEK. Good morning, Mr. Chairman.

Senator STEVENS. Nice to see you.

TESTIMONY OF L.J. "LUD" ANDOLSEK, PRESIDENT, NATIONAL ASSOCIATION OF RETIRED FEDERAL WORKERS, ACCOMPANIED BY TOM TRABUCCO, ASSOCIATE LEGISLATIVE DIRECTOR, AND JAMES R. STOREY, CONSULTANT

Mr. ANDOLSEK. I am Lud Andolsek, president of the National Association of Retired Federal Employees. It is a pleasure to be here today to work with your committee in the construction of a supplemental program for new employees. As one person can't have all the facts at the top of his mind, I have with me two experts: Tom Trabucco, our associate director of legislation, and Jim Storey, who is a consultant and an adviser on this program.

I just want you to know I have two associates here with me who can help in case something comes up that no one person can keep in his mind. Judith Park is not in the city and could not be with us today.

Although the benefits of this program will not directly affect our members who are already retired, we feel privileged to provide you with a look at this important matter through the eyes of age.

We, more than anybody else, recognize the legitimate purposes of a retirement system. Our 500,000 members include former Government managers who understand the need to provide a sensible progression into retirement so that new generations may take over the reins.

As current retirees, we, more than others, recognize the income replacement and security needs of those who have completed their careers as productive wage earners and earned the right to retire in dignity.

As patriotic citizens, we support the social safety net established in our national policies for half a century and most often achieved through retirement programs for the productive members of our society and their families.

Workers under our program are a part of an elite few who take an oath to support and defend the Constitution when they enter on duty.

Finally, as those who have felt the ebb and flow of political tides enrich and then threaten our dignity and security, we recognize the need to insulate this new program as much as possible from political pressures. This means neither hiding it nor putting it totally beyond the reach of political leaders.

What it does mean is constructing a plan which is consistent with the private sector practices, while recognizing the unique needs, the unique mission of a unique employer—the Government.

Mr. Chairman, scores of issues must be resolved over the next few months concerning the design of a supplemental plan. Your bill, S. 1527, provides a very good framework for arriving at sound decisions.

First, you propose a three-tiered plan using Social Security as a base. This is complemented by a mandatory defined benefit plan and an optional capital accumulation plan. After 2 years of extensive and expensive study, this is NARFE's preferred approach.

Second, your proposal properly continues the civil service retirement trust fund as the one source of funding for the defined benefits of both old law and new law workers. Revenues are not, and should not, be earmarked by plan. This is critical, Mr. Chairman, to maintain the security of millions of workers and retirees under the current civil service retirement system. We wholeheartedly support this approach.

Although it may seem like a minor point, Mr. Chairman, I am compelled to comment on the title of S. 1527. It is referred to as the Civil Service Pension Reform Act. The current system does not grant pensions, which are defined as gratuities. Rather, the current system provides earned annuities to those who have paid into the system for years with dollars and labor. Annuities are not, and annuities should not be construed as, gifts.

Mr. Chairman, the civil service retirement system is 65 years old. If it were a person, it would be entitled to full Social Security benefits. It must be protected during its golden years. Under the structure and funding you propose, the goal can be met.

As a retirees' organization, we have a unique opportunity to gain a full understanding of retirees' concerns. It, therefore, is not surprising that one of our primary areas of interest is the limited cost-of-living protection contained in S. 1527.

Federal retirees were the first to come under automatic indexing rather than the overgenerous political indexing which governed Social Security for years. NARFE has been the first retiree group willing to discuss some restraint, across the board, on the current cost-of-living protection. But we must again call for equal inflation protection on all non-means-tested, federally administered retirement benefit programs.

The Congress spoke clearly and correctly on this matter last July. On this issue, the Congress should not renege, and NARFE will not retreat.

Concerning the appropriate mix of benefits in the retirement package, NARFE recommends that more emphasis be placed in the defined benefits component. Recent tax proposals have underscored the vulnerability of capital accumulation plans. While partially deferring income until retirement is desirable, it is not a substitute for the security of an adequate defined benefit plan. The generosity of the thrift plan could be pared back to mitigate the costs of improving the defined benefit component.

NARFE also recommends continuing the tradition of employee contributions to offset the costs of an improved defined benefit.

Concerning the investment of thrift plan funds, we think the statement of the Comptroller General on Monday is instructive, not for what it says, but for what it does not say. According to GAO, "The initial requirement of all thrift plan funds to be invested in Government securities could have a positive impact on the budget by reducing outlays for at least the next 5 years."

Of course, the obverse is also true. If these funds go outside Government after 5 years, the budgetary impact could be enormous.

NARFE believes that for pragmatic, political, and even public relations reasons, these funds should be invested in Government securities. Substantial returns could still be achieved, especially if the funds are invested as GAO recommends.

The capital accumulation plan is a bold endeavor, certain to come under close public scrutiny. We think that taxpayers will hold the plan in higher regard, in higher esteem, if it is viewed as a way for Federal employees to invest in their Government rather than as a way to set up civil servants with a stake on Wall Street.

Finally, we want to address the question of allowing pre-1984 employees to opt into the new system. S. 1527 proposes a one-time open season to permit such elections.

We understand the interest in allowing an election, but it would raise three problems that must be considered:

First, the Social Security Act would have to be amended to allow coverage of Federal employees at the individual employee's option. This issue would be unique in the history of the Social Security system.

Second, the choice being offered to employees would be extremely complex, and many people would, no doubt, make unwise choices they would come to regret later. This problem was cited by a witness at the House hearing based on experience in Maryland, when State employees were allowed to choose between two different retirement plans.

Third, when you have open season, you have set a precedent. What would be done for those who inevitably would fail to exercise their options for some unforeseeable compelling circumstances? I assure you, as time goes by, there will be many with unforeseeable compelling circumstances that did not take the option.

It seems that a good alternative to consider, instead of the retirement open season, would be to permit pre-1984 employees to participate in the capital accumulation plan. Even if their contributions were unmatched, the tax-deferred saving option would satisfy the major reason for any interest of pre-1984 employees in the new system.

In summary, Mr. Chairman, there is much to debate before final legislation is enacted, but you have given us a good framework within which to conduct that debate. NARFE applauds you for your efforts and those of your colleagues as you tackle the design of a supplemental plan.

We stand ready, we are willing, we want to work with you in producing the best possible plan that meets the needs of the employer, the needs of the employees, the needs of the retirees, and yes, the needs of other taxpayers.

We feel the action taken by this Congress can and should become the role model for all employers of this country, both public and private.

Thank you for permitting me to be here, Mr. Chairman. I would be happy to answer any further questions you may have.

Senator STEVENS. I thank you very much. The committee thanks you for your presentation. Recognizing the sensitivity you mentioned about the name of the proposal, I don't think we are wedded to including pension in the name of it. It could be the Federal retirement system or something similar. It will have to be different from the civil service retirement system, though. But we will look at that.

Mr. ANDOLSEK. I say that because of my personal concern about that. My father in Minnesota who worked with a pick and shovel underground would have received a pension. If he had worked a certain number of years, they would have had a lunch for him and given him a watch. That is all he would have had when he was through. If he had lived long enough, he would have been entitled to social security. But he died before Social Security became law. I don't think we should treat people without compassion in the senior years of their lives.

Senator STEVENS. There is a difference. The new Federal employees will not contribute to the second tier.

Mr. ANDOLSEK. Sir?

Senator STEVENS. The new Federal employees will not contribute to the second tier.

Mr. ANDOLSEK. I understand that.

Senator STEVENS. There is a difference. It is a Federal retirement system. We will see what we can do to work on that.

Mr. ANDOLSEK. Thank you, sir.

Senator STEVENS. As far as the COLA comment is concerned, you mentioned that we should be attuned to the problems of being compatible with the private sector, and yet there are no COLA's in the private sector with any regularity. There have been adjustments. They are not automatic, that is for sure.

We opted to create the third tier, and the cost of the third tier is equal to the cost of the COLA in normal years.

Mr. ANDOLSEK. We commend you very highly for that third tier. We think your whole package is a very good package to start from.

Senator STEVENS. You can't have both, though.

Mr. ANDOLSEK. NARFE strongly recommends equal protection for all Federal retirement programs, no retreat and no surrender. We have not called for full CPI indexing for generations yet unborn.

We have commissioned a study at our expense to identify ways to restrain COLA costs without eliminating the base on inflation. Thresholds, longer interim periods, compounding and CPI minus are all options, but it must remain inflation-based and apply across the board.

Senator **Stevens**. I want you to think about the fact that the third tier is an inflation-based COLA concept. It takes the same cost of a COLA, 3 percent of payroll or more. We are putting it up to 5 percent of payroll, and it matches the employee's savings with an inducement to save up to 10 percent.

The marketplace is, in fact, COLA adjusted, so that it gets you more than the 3-percent COLA that has been the average. It gets you 5 percent, but because of the induced savings, it actually gives you more COLA protection for the future than the traditional COLA would.

So, I would urge you to take a look at what the thrift plan is. The thrift plan is a COLA mechanism. It was designed to prevent demands for COLA's in the periods when inflation might, God forbid, be what it was before, 15 percent. None of those adjustments were a full COLA.

I appreciate what you are saying, but I don't remember a full COLA adjustment.

We always came in on a less than COLA basis by definition because the studies that were presented to Congress were 18 months old by the time Congress acted, and usually, it was 2½ years before we reacted. In an inflationary curve going up, we were always below COLA in the current year.

The employee's third tier will be adjusted not only by inflation, but by appreciation in terms of investments in appreciated stocks.

I would urge you to take another look at that from the point of view of being a COLA mechanism.

Mr. **Andolsek**. But I would like to make this observation. In my 42 years of Government, and I went from the bottom to pretty high, very few of the employees that have families, and youngsters, and parents to take care of could take advantage of your third tier. Our upper echelon would take advantage of it.

Senator **Stevens**. The studies we have show that 74 percent of the people with an under $15,000 income participate in these plans where they exist. They contribute 7 percent of their money unmatched. Matching is the incentive here.

But for these young people who tell us that Social Security won't be there—I don't believe it, but that is their fear—you see time after time their polls saying "The money won't be there."

This is their hedge for the future and it restores the American ethic of saving.

Mr. **Andolsek**. When Social Security is gone, America will be gone.

Senator **Stevens**. I don't know. America lived a long time before Social Security, my friend. I remember my grandfather didn't have Social Security, but he saved about 8 percent of his pay out of every paycheck he ever got.

Mr. **Andolsek**. I have a young daughter who is an M.D. The Government will have money for her Social Security plan. They are sold on this program.

Senator Stevens. We assure Government employees faith in Social Security. They have to have it.

Mr. Andolsek. Have to have it.

Senator Stevens. Because they are now in it.

Mr. Andolsek. Tom, do you have an observation you want to make?

Mr. Trabucco. Senator, you made the observation that the cost of the third tier is similar to the cost of the COLA protection, and indeed that is true.

Senator Stevens. In normal times, Tom.

Mr. Trabucco. Right, but reflecting the views of retirees, the value of cost-of-living protection is critical to these people. This is a primary concern to people who are not sophisticated investors in the market who will move money around, but people who feel that they have contributed and deserve to be protected from inflation.

That may change over time, granted, but the basic goal of security protected from inflation in retirement probably will not change.

Senator Stevens. I agree. We have three tiers. There is the full COLA on Social Security in the first tier. That is assured now. The second tier is an inflation-adjusted concept, but minus 2. Then, in the third tier, there is the ability to go beyond COLA in terms of appreciative values.

I don't know how it could be more oriented toward the attitudes of the people who would be involved. I really think we ought to take a full reading of the people who are affected. We will try to do that once we get this system under way.

You know that in all these hearings, we have yet to hear from a person affected by the bill? Does that strike any of you? Not one person that has been before us has been a person who wasn't covered by the civil service retirement system and will not be covered by the new bill. We have yet to hear from an employee who is, in fact, a new employee as to what they really want.

Mr. Andolsek. Let me have Jim make a point.

Mr. Storey. I am not a new employee, Senator, but if I ever return to the Government, I will be covered by this bill, probably. I wanted to add to the reaction about——

Senator Stevens. You will also be covered under the old one, true?

Mr. Storey. It could go either way. I wanted to add to the reaction about using the CAP for inflation protection. It is quite true that when you are contributing to the capital accumulation plan and you are earning interest on your investments, you are likely to keep up with inflation or do better than inflation, inflation based on historical value. There is no question about that, although there is no guarantee you will over a particular period of time.

The problem is that after you retire, you normally will start drawing down on that asset through a fixed annuity, and a fixed annuity is not adjusted for inflation. If you purchased a variable annuity, so that you did have some inflation protection each year, then you would start off with a lower replacement rate at the time of retirement.

I think that is something to be concerned with, relying solely on the capital accumulation plan.

Senator **Stevens**. We have assumed that the average person who has an accumulation in excess of $100,000 and would pay taxes on it if he or she took it out upon retirement age would roll that into an IRA. Again, I want to call your attention to the fantastic participation in IRA's. It is not something that is an unknown quantity to the working people of this country.

We have almost 40 million of them in place right now, and over half of those are by people who have under $20,000 in income. I believe that by the time any of the people covered by this plan are ready to roll that money over, they will be able to understand how to handle it, and the systems will be there.

Also, the system for investment will be there, as far as the uninformed investor, with managers capable of selecting portfolios that give great diversity and protection against inflation. Again, it is my judgment that coming Congresses will not be able to grant COLA's in the full sense.

Lud won't like to hear that.

Mr. **Andolsek**. We are flexible, and we said a long time ago, we will talk as to what should be done. But we strongly urge you to consider seriously that it must remain inflation based and apply across the board. It is a test which every person must take, equal love to each child, a doctor, a teacher, a blue-collar worker, equal devotion to each; regardless of their station or achievements, as long as they each did their best, equitable division of the estate when the time comes. Underaged could learn from that experience.

Senator **Stevens**. That is what the first tier is, Lud, that is Social Security. Everyone in the future will have the same treatment as far as the first tier is concerned.

Mr. **Andolsek**. I found out in my long career, and I started in 1936 with the National Youth Administration, when the paycheck came, there were so many obligations we didn't have an opportunity to put it aside. We were protected by the bank, the FDIC, and so on, and so forth. The National Youth workers were conservative. Some of them have opinions politically. Basically, we are financially conservative on what we do.

I strongly urge you to consider this. It doesn't have to be what it is now. We have got the means, and methods, and studies that we can work out something. It should be across the board, and we strongly recommend that.

Senator **Stevens**. All right, we hear you.

Senator Glenn.

Senator **Glenn**. Thank you, Mr. Chairman. Just a couple of questions here. I understand Senator Eagleton is on the way, and he asked that I ask a couple of questions on his behalf also. But first I have a couple of questions.

On the proposal in the bill to raise the retirement age from 55 to 62, there is some legitimate concern, I think, expressed about the impact of that provision, particularly with regard to the more physically demanding jobs, letter carriers, people like that who may develop difficulties, just physical difficulties, in the latter part of their employment period.

If we keep that provision, we want to make sure there are adequate means for workers who cannot wait until age 62 to retire, to make sure the disability system eligibility criteria takes special occupational factors into account.

Do you have any comments on that? How can we do that?

Mr. ANDOLSEK. Let me take these separately. Retirement is an orange herring, not quite red. Few employees retire at age 55. The average age in Government is just 1 year lower than the average age in the private sector. Under the three-tier approach, even the slight difference will disappear. Social Security will not begin until age 62. Thrift plan funds are not available until 59½. Those who do retire at 55 have met the age and service requirements. They probably have military service credits. They were worn out, they want out, and we certainly don't want those people in our work force. Some people get old at 60 and can't pull their share of the load, and they want to get out.

I found, in my experience on the Civil Service Commission, about five reasons where people went out at 55 and 30. One, they had an ailment where it was a chore to get dressed and go to work. Two, they didn't like their job. They weren't given enough responsibility; it was a routine or repetitive work; they didn't like their supervisor. The minute they hit their 55th birthday, they walked in and said they were quitting. It is not true they all go out at 55 and 30. Once in awhile you lose a lot of brilliant people. Many find work in the private sector to earn their benefits under the Social Security retirement system.

Senator GLENN. Fifty-five would only be for those who were impaired somewhat?

Mr. ANDOLSEK. No, no; I said that was my experience; 55 and 30 should stay in the law and give these people an opportunity to go out with full credit that they have at the time if they want out. I don't think we want in our work force somebody who wants out and just have them dragging in there and precluding younger people from coming in and filling in behind them.

Let me take the special categories. We support continually——

Senator GLENN. If I could interrupt you, you could use that same argument at 45, or 35, or any other level. There is nothing magic about 55 and wanting out because you got mad at your boss.

Mr. ANDOLSEK. I use 55 because this was an age that Congress passed some time back. I didn't go out at 55. I stayed up until 67, see. I had my 80 percent at the end of my first term as a commissioner in February 1969.

But I enjoyed my work. I thought I was doing something for humanity, so I stayed. But there were others who were just disgusted with their jobs and walked out.

There are special category cases. We support reviewing the special retirement benefits according to certain employees like firefighters, the law enforcement officials. If their duties have become less demanding, if the commonsense need for a young and vigorous work force disappears, so should the very special retirement business.

Unfortunately, that day has not yet arrived for these gallant employees or the survivors of their colleagues who have fallen in the line of duty. In our opinion, these special retirement privileges should continue.

Senator GLENN. Another question. We need the antithesis of that, I guess, a little bit, because once we have got people, we want to set up a system that is going to retain them. We want to encourage them in, not encourage them out. I have been concerned about that aspect of this, also.

What would you think if we put in something like an increased pension accrual rate for tier two for longer term workers, maybe a graduated rate, for instance; more than 1 percent for years 11 to 20 and maybe increase it from 20 to 30 or something like that, so it would be only an upgraded scale which would encourage them to stay in and not go out? You have got a lot of experience of good managers who get in there, and then they are also attracted to private industry, and private industry can outbid any GS rate that we set up.

Mr. ANDOLSEK. In our full testimony, Senator Glenn, we say we support a backloaded formula to recognize career civil servants. In the plan we prepared, we call for a 0.95-percent rate up to 10 years and a 1.25 rate thereafter, but we are flexible. This will not undercut the portability, the three-tier approach, including Social Security and capital accumulation, but it does encourage career service, which we see as valuable.

Tom had an observation he wanted to make on the previous question.

Mr. TRABUCCO. Senator, on the issue of age of retirement at 55, it is also important to remember that along with that requirement comes a 30-year service requirement, which is often overlooked. That decreases the number of people who can take advantage of it but rewards that long-term career employee.

Senator GLENN. Yes, good point.

Senator Eagleton had asked me to ask these questions if he was not able to be here, so let me just ask them the way he had them stated here.

You stated that the deficiencies in the Stevens bill can be summed up in one word: "value." In computing the value of the Stevens plan and in comparing it to the existing program, did you take into consideration such things as the value of portability to employees and the value, particularly for younger workers, of survivor and disability benefits under Social Security?

Mr. ANDOLSEK. Let me ask Jim Storey to respond to that. He did all this work for us.

Mr. STOREY. NARFE has been developing its own proposal, and all of these issues have been fully taken into account.

Obviously, there are tradeoffs all along the way in everything to design this kind of system between the benefit levels, retirement age, portability, indexing after retirement, and so on.

NARFE has been fully taking into account all of these considerations in coming up with what they thought was the best kind of system.

The point about value, I think, is primarily one of what the total Federal investment in the system should be. NARFE feels that it should be more similar to the current system than to the 20.8 percent that has been estimated for S. 1527.

Senator GLENN. These have been called sort of intangibles, I guess. They do have a value to employees, obviously, even though there is not a direct dollar value hooked up to them. But you are taking them into account in your consideration.

Mr. Storey. With respect to portability, Social Security and the thrift plan greatly increase the portable nature of retirement credits compared to what we have for current civil servants under the civil service retirement system.

Senator Glenn. Second question.

Mr. Andolsek. Senator, let me just add there, we are the first to admit that a good retirement plan is not cheap, but a cheap retirement plan is not good.

Senator Glenn. Very good. [Laughter.] I will buy that all the way. [Laughter.]

Second question for Senator Eagleton. I think you have alluded to this or the chairman did a moment ago and discussed it very briefly.

I note that you are not in favor of allowing CAP contributions to be invested outside of Government securities. Can I assume from this, then, that you are not of the school to blame the unfunded liability of the current retirement system on the fact that by law, it can only invest in Government securities?

Mr. Andolsek. No; I think our position was more from experience. Our Government employees, like the military, take the oath of office when we come to work, and we would like to have these thrift plans all in Government securities. We give our reasons in our full testimony. The pragmatic, political, and public relations reasons will permit this kind of a situation. Let me give you all the reasons.

I believe when Wall Street was littered with broken bodies of sophisticated investors in 1929 their sin was investing more than they could afford. How much can a GS-9 worker afford to lose in an era of pay caps, his retirement security? How about retirees facing COLA delays? Let's give them a fair defined benefit retirement package, a chance to invest in America, and be done with it.

To me, I have not speculated in the stock market. I couldn't afford it. I learned long ago if I was going to speculate in the stock market, I have to do the same thing as I do in Las Vegas. I have to be able to lose that money and not hurt my wife, or my children, or my dear ones. A person who cannot afford to lose should not be speculating in the market; 1929 was not long ago. That is when people were jumping out of skyscrapers.

As part of the Government, we would like to see these moneys invested in our Government securities and let the Government take the benefit.

In addition, when you invest in the Government, they do not become a budget item.

Senator Glenn. I am for making this, whatever the funding is, as solid as we possibly can. We don't want people bailing out of windows or anything like that.

On the other hand, I think there should be a split funding arrangement or a certain percentage collected to invest in the private sector or invest in whatever. It might get a better return than just Government securities. I wouldn't be against that, at least. I haven't locked in either way on this. I wouldn't want to see it all go out speculative only, because you are going to run this thing bankrupt, obviously, and then everybody would be out.

On the other hand, to make it just a flat law that you cannot, by law, invest in anything except the lower yielding Government securities also may be stymieing us, too.

When you are talking about investing in America, we are investing in a free enterprise system here, always, in addition to just Government functions. I would like to at least consider maybe some split percentages of some kind or another that could be permitted under different kinds of investment.

Mr. ANDOLSEK. The Government has increased the interest on the savings bonds, which made them much more acceptable to people. You have to control what their interest is going to be; advise long-term bonds that pay more interest than the shorter 2-year terms.

Senator GLENN. Sometimes, it is like back many years ago, as the chairman mentioned, when we had 21-percent interest rates and 17-percent inflation rates for a short period of time there.

That scared an awful lot of folks, me included.

Mr. ANDOLSEK. Me, too.

Senator GLENN. It resulted in some swing in the other direction. We have an economic policy now which is draconian by my standards, at least, in the other direction where the current rate is a $230 billion a year deficit. So we have some violent swings here, but we want to protect against what can happen there, and maybe in times of high inflation, it might be advantageous in a fund like this to have some of it in a fund that will keep up with inflation rather than just low-yield Government securities.

Mr. TRABUCCO. Senator, since you mentioned it, it is one of our political concerns on these funds going out. We recognize the attraction of getting funds out to higher yield types of vehicles.

We also support the free-enterprise system, but we recognize that once those moneys go out, they have a budgetary impact. They would increase the deficit, and after what we have recently been through over the last 5 years, from a political perspective, we are not sure that that is a wise choice.

Senator GLENN. Just so I make it very sure for everybody in the audience here today, I haven't locked in on this. I am not proposing today we put this in speculative items or any portion of it. I think it is something we need to look at.

Mr. ANDOLSEK. These are our recommendations, and we are flexible. I very well remember that NARFE was excited about the same thing you mention, when Tom Walters was president of NARFE, a good friend of mine now long gone. It was a bad situation that created the kicker that Congress passed, which has been abolished.

Senator GLENN. Thank you very much.

Senator STEVENS. Thank you.

Well, I hope we keep in mind some things. In the first place, when we started this retirement concept, we had some hearings 5 or 6 years ago, and the advice was to look out into the future to see what is going to happen to the people who are coming in now in the 1980's. When they retire past the turn of the century, you are looking at 2010.

At that time, we were told one-third of the population would be too young to work; one-third of the population would be retired; and one-third of the population would be working. That one-third that would be working could not afford to both pay COLA's for the third that had already retired and pay the educational costs for the people who were too young to work.

Our warning was: Don't plan on COLA's in the future. This is designed to meet that need.

Another thing is, when Social Security was first devised, the life expectancy of the American people was much lower than today. Today, the life expectancy of these people is 78 and 79. We are talking about, at age 62, at least 15 years of retirement on an average in terms of the current life expectancy, which ought to be even greater in 20 years. We have got to build a retirement system that will be safe in 2010.

The only thing that is going to be safe if this country survives is, in fact, the private sector. We have the incentive to save. In the future it is off budget; it comes out of the budget in the future. But it is the greatest thing for capital formation going in our country. Because for every dollar the Government contributes, the employee saves a dollar. That is 200 percent as compared to 100 percent in terms of capital formation.

The greatest problem of our economy at that time will be the problem of capital formation. I don't know what the projections will be, or how much money will be in the fund. We have a great argument about that. But as a practical matter, there will be a substantial impact on the private sector in sustaining the private sector through the savings of Government people. To me, if you look out to 2010 and get away from the 1980's, I think more people would understand this plan. If we can't get out to 2010, then we ought not to be writing this bill, because that is when the people under this plan are going to retire.

Mr. **Andolsek**. But Senator, you are absolutely right. Tom's predecessor, Steve Shardon, used to tell me that I am not normal. If I were normal, I would have been dead long ago. I will be 75 in November. I am way beyond the expectations of my generation.

But do consider the medical health benefits program. Do you want to create another chaos like we have there? At that time, I said the Government was big enough to self insure, and we could have designed one program where everybody would have the same benefit program for health benefits. But look at the chaos you have got now. When I was on the Commission, we had 39 plans. Now there will be 200 and HMO's and everything.

Senator **Stevens**. Take a look at what would happen to the plan. The worst thing is that it would be taxable and the Government could no longer contribute. If the savings ethic was started for, at the very least, a deferred compensation concept, it would keep the ethic going and have a staggering impact on the private sector with the increased capital available for investment.

If this continues for a period of 30 years, the savings is going to be substantial and have a significant impact on continuing the capital formation needs to sustain a private enterprise economy well into the next century.

We are getting locked into our own experiences.

Mr. ANDOLSEK. Look what happened to the savings and loan institutions recently. People honestly and sincerely put their money in there and now they have to limit themselves to withdrawals of $1,000 a month.

Senator STEVENS. You read our bill again. In the first place, there is the option for putting all you want into Government securities. That is, if that is what you want to do, if you want security, total security in Government, put it there. If you want to take some risk, put it in the area where managers are going to put it in the private sector.

But no managers of moneys in the private sector pension funds are ever going to put money in a State-authorized savings and loan.

Mr. ANDOLSEK. Not any more. [Laughter.]

They did once.

Senator STEVENS. They wouldn't have in the past.

Mr. ANDOLSEK. First, I don't think—to go to a broker and start talking about investment, the average Government employee doesn't know anything about it. I think I am average. I didn't know what a coupon clipper was until I came to NARFE.

Senator STEVENS. If you are average, we better quit writing these bills, Lud. [Laughter.]

Mr. ANDOLSEK. I am serious.

Senator STEVENS. I understand what you are saying. We appreciate your contribution. I hear you. I hope you will understand where we are coming from.

Mr. ANDOLSEK. Thank you.

Senator STEVENS. Thank you very much. Thank you very much, Mr. Storey.

[Mr. Andolsek's prepared statement follows:]

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STATEMENT OF
THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
ON S.1527, DESIGN OF A SUPPLEMENTAL RETIREMENT PROGRAM FOR FEDERAL EMPLOYEES HIRED AFTER 1983

Tuesday, September 10, 1985

I am L. J. "Lud" Andolsek, President of the National Association of Retired Federal Employees (NARFE). It is a pleasure to appear before this Committee to assist in the construction of a supplemental retirement program for new employees. Although the benefits of this program will not directly affect our members who are already retired, we feel privileged to provide you with a look at this important matter through the eyes of age.

We, more than anyone else, recognize the legitimate purposes of a retirement system. As former government managers, we understand the need to provide a sensible progression into retirement for older workers so that new generations can take over the reins. As current retirees we, more than others, recognize the income replacement and security needs of those who have completed their careers as productive wage earners, and earned the right to retire with security. As patriotic citizens we agree with the legitimate need for a social safety net established in our national policies for half a century, which is most often achieved through retirement programs provided by employers for the productive members of our society and their families.

Finally, as those who have felt the ebb and flow of political tides enrich and then threaten our dignity and security, we recognize the need to insulate this new program as much as possible from political pressures. This means neither hiding it nor putting it totally beyond the reach of political leaders. What it does mean is constructing a plan which is consistent with private sector practices while recognizing the unique needs and mission of a unique employer -- the government. It means creating a program which both employees and the public can understand and view as fair; it means guaranteeing the program's fiscal health through an unwavering commitment by the U.S. government itself; but -- most importantly -- it means designing a program which will attract into the public service the "best and the brightest" so that the Federal government, as the Nation's largest employer, is also its model employer.

NARFE believes it is important to design a new plan that will satisfy several major goals:

- It should provide an adequate retirement income for the new employees across the full spectrum of job classifications and salary grades;
- It should be a program that will be fair to new hires, the 5 million employees and annuitants still under the current Civil Service Retirement System, and the public;
- It should be funded in a manner that will protect the financial integrity of the current system into the future;
- It should meet the federal government's continuing need to attract and retain a quality workforce that can execute the many different functions of government at the high performance level to which the American taxpayer is entitled.

How do we translate these goals into a supplemental retirement program?

Mr. Chairman, the bill that you and Senator Roth have introduced to establish a retirement system for federal and postal employees hired since December 31, 1983 is a good starting point. Our organization has had this matter under study during the two years since Social Security coverage was enacted, and the conclusions we have reached about the most desirable approach coincide with your proposal in many ways.

You have proposed a three-tier system for the new employees. We strongly support this concept. Social Security should be supplemented with a defined benefit plan that each covered employee can count on to provide an adequate income in retirement when added to Social Security. We also agree that the supplemental should be an add-on, as you propose, and not offset by a part of Social Security.

Experience in the private sector has demonstrated that the third tier of your plan is also an important employee benefit. Saving for retirement through a tax-deferred capital accumulation plan is now widely recognized as an effective way to build additional retirement assets for those who want the security of the extra income such assets can generate.

We applaud your bill for its commitment to continue the existing Civil Service Retirement Trust Fund on a financially sound footing. We agree that the existing fund should serve both the current system and the new plan on an integrated basis that does not earmark revenues by plan. It is essential that we keep faith with current retirees and those who expect to retire under the current system and assure them that the new plan will not weaken the strong financial outlook for the Trust Fund.

We appreciate the work you and your staff have put into development of this very complex legislation, Mr. Chairman. We feel that you have given the

Committee a well-structured proposal for markup. I want to urge you and the other Committee members to use the markup to remedy those provisions that we believe do not serve the best interests of retirees, federal and postal employees, or the government as employer.

The deficiencies of S.1527 can be summed up in one word - value. According to the analysis of the Congressional Research Service, the average employee would contribute 8.9 percent of salary to receive a benefit worth 29.7 percent of salary. What these numbers mean is that the employee's contribution would be 1.7 percentage points greater, but the benefit would be worth 2.5 points less than now exists. This total swing in value to the employee of 4.2 percent of salary would amount to a reduction of one-sixth in the value of the retirement program for the new hire as compared to other employees.

The excellent study of compensation produced by Hay-Huggins for the House last year found that total federal compensation lags the average private firm's by 7.2 percent. That means that it lags the top firms by even more. While the Civil Service Retirement System was 6.4 percent better than the average firm's retirement plan, it was found to be less generous than the plans of at least 85 of the firms in the study. These results mean that when the federal government goes up against the IBMs and the DuPonts in the labor market, it offers the job prospect lower pay, a less generous health plan, and lower retirement benefits. How can we seriously consider worsening this situation by cutting the current retirement package by one sixth?

We suggest the Committee consider two ways to reduce the government's cost under the proposal and provide more room for benefit improvement.

First, NARFE believes the long-standing tradition of employee contributions should be maintained. A 1.3 percent retirement contribution, combined with the Social Security contribution, would maintain equity between the new hires and their colleagues, provide more funds for needed benefits, and continue the politically important employee financial stake in the retirement system.

The second way to provide funds for benefit improvement is to pare back the proposed capital accumulation plan. The proposed dollar-for-dollar match on the first 5 percent of pay is much more generous than the matching in most private sector plans. This generosity would not only exceed current practice, but it would also fly in the face of the growing pressure from the Administration and some Members of Congress to curb the extent to which income can be tax-deferred through retirement saving plans.

Now that we've shown where money can be saved, we would like to identify our priorities for improving the defined benefit plan.

As a retiree organization, we recognize more than others the absolute need to protect retirement income from inflation. As a nation, we need to come to grips with the difficult issue of protecting all retirees equally from inflation. One indexing policy should be applied to Social Security and to all the non-means tested retirement programs administered by the government. This is the best way to use the powerful presence of the government to encourage private workers and employers alike to work toward a uniform indexing policy on the retirement benefits of all workers.

Under the proposal before this Committee, if you retired with a benefit worth 30 percent of the high-5 and lived for 20 years, you would wind up with a benefit in real dollars that was worth only 20 percent of pay if the COLA were CPI minus 2. Losing one-third of the value of your earned retirement as you grow older cannot be called enjoying the golden years of senior citizenship. I call it bad policy. It is a policy that Congress has rejected time after time in recent years. We suspect Congress has rejected these proposals in part because of their long-term effects. As one OMB official was quoted recently, "It's only fine if you don't live very long after retirement."

NARFE strongly believes that the COLA for the supplemental should be tied to Social Security's COLA. COLA policy could then automatically follow whatever policy Congress should decide for Social Security, and the government's plan would be treated no more and no less generously than Social Security at any given point in time.

Second, let's look at the basic rate at which benefits are accrued and the salary base used to compute benefits. The proposed rate of one percent per year of service would provide a benefit worth 30 percent of the high-5 average salary for the 30-year employee at age 62. When added to Social Security, this benefit is equal to that under the current system for an employee making somewhat less than $20,000 a year. Everyone above this salary level would have less wage replacement from Social Security and therefore would have less in combined benefits than under the current system.

NARFE believes this break-even salary level of under $20,000 is too low. It is unrealistic to expect that most people in the $20,000 to $30,000 salary range will participate so substantially in the saving plan as to make up this difference in benefits. For example, this salary range covers most postal clerks and letter carriers. The result of the proposal would be to help the lowest-paid employees, who would be better off, and the highest-paid employees, who will take advantage of the CAP, but to penalize the below-average and average employees relative to current law. An accrual rate of about 1.15% using a high-3 salary base would move the break-even salary up to $30,000, which would guarantee all below-average employees that they would do at least as well as they would under the current system.

The cost of this accrual rate could be mitigated somewhat by continuing the current policy of a backloaded benefit formula which is lower in the early years of employment but increases with seniority. Accrual rates in the neighborhood of .95 for the first 10 years and 1.25 for long service would be appropriate in our view. Such an approach would save some money and encourage career employment while not diminishing the increased portability afforded short term workers through Social Security and a capital accumulation plan.

Another priority is the unreduced benefit at age 55 for the career employee with 30 or more years of service. There are two reasons for retaining the current age-service requirement. The first is the opportunity for an adequate retirement that a 30-year employee richly deserves. Preserving this right at age 55 would not be a costly change to the bill.

The second reason to retain the present retirement criteria is that taking an action to delay retirement age makes no sense given the trends in employment. There is little chance that the number of government jobs will rise much in the foreseeable future. To encourage retirement at later ages would mean fewer new hires, fewer promotions, an older workforce, and a workforce with less performance incentive. Retirement age policy must be viewed from the perspective of government as employer. Basing such policy purely on budgetary grounds or macroeconomic considerations makes no sense. We see evidence all around us in the private sector that firms in no-growth situations often use retirement as a key element in maintaining a viable workforce.

We also want to comment on several provisions in the disability and survivor plans that appear deficient. With respect to disability, we believe that benefits and the average base on which they are computed should be adjusted based on a national indexing policy.

The proposed rules for survivor benefits also require some attention. First benefits for survivors of annuitants, or employees who die in service, should begin at time of death. Second, the phasedown in the life insurance to be provided by government occurs at too early an age. If a phasedown is used, it should be no earlier than age 50 in order to be more helpful in meeting the actual financial needs of survivors.

Now I want to comment on the investment of funds in the capital accumulation plan. We feel strongly that all funds should be invested in government and government-guaranteed securities. There are several reasons why we have come to the conclusion that this approach is best. First, it avoids the potential for the political and administrative pitfalls that could well be created if large amounts of money were placed with numerous private vendors. Second, we think that taxpayers will hold the plan in higher regard if it is viewed as a way for federal employees to invest in their own employer, the U.S. Government, rather than as a way to set up civil servants with a stake on Wall Street. Third, and perhaps most persuasive of all, placing the funds outside of government would increase the budget deficit by scores of billions of dollars, a result which would surely come back to haunt the Congress as well as jeopardize the continued viability of the capital accumulation plan.

Finally, we want to address the question of allowing pre-1984 employees to opt into the new system. S.1527 proposes a one-time "open season" to permit such elections. We understand the interest in allowing an election, but it would raise two problems that must be considered. First, the Social Security Act would have to be amended to allow coverage of federal employees at the employee's option. Opening up the coverage issue could be dangerous at a time when budget pressures make new Social Security revenues attractive. Second, the choice being offered to employees would be extremely complex, and many people would no doubt make unwise choices and come to regret their decisions. This problem was cited by a witness at a House hearing based on experience in Maryland when State employees were allowed to choose between two retirement plans.

It seems that a good alternative to consider instead of the retirement open season would be to allow pre-1984 employees to participate in the capital accumulation plan. Even if their contributions were unmatched, the availability of tax-deferred saving would satisfy the major reason for any interest of pre-1984 employees in the new system.

In summary, Mr. Chairman, there is much to debate before final legislation is enacted, but you have given us a good framework within which to conduct that debate. NARFE applauds your efforts and those of your colleagues as you tackle the design of a supplemental plan. We stand ready to work with you in producing the best possible plan for retirees, Federal and Postal employees, and the government as employer.

Senator STEVENS. The next witness is Dennis Tito, president of Wilshire Associates, Santa Monica, CA.

Good morning, sir.

TESTIMONY OF DENNIS A. TITO, PRESIDENT, WILSHIRE ASSOCIATES, SANTA MONICA, CA

Mr. TITO. Good morning.

Mr. Chairman, my name is Dennis Tito. I am president of Wilshire Associates of Santa Monica, CA. Wilshire Associates is a consulting firm that provides guidance and operating systems to over 300 pension funds, profit-sharing funds, endowments, money managers, and bank trust departments. In addition, we are members of the New York Stock Exchange and Registered Investment Advisors.

I would like to limit my comments today to the thrift savings plan option provided for in subchapter III, which is an optional plan permitting participants to contribute a percentage of their basic pay or disability benefits to a selected investment vehicle and have those contributions matched by the Government.

We believe that subchapter III provides an important new avenue whereby Federal employees can enhance their savings for retirememt while providing important new sources of investment capital to the public and private markets.

In addition, the thrift savings plan as outlined in subchapter III appears to be competitive with plans offered by the private sector, which should help increase Federal employee morale, job satisfaction, and retention.

The legislation properly provides Federal employees with three options for the deployment of their assets: a Government securities investment fund; a fixed-income investment fund; and a common stock index investment fund. These options will allow individual Federal employees to tailor their investments to their unique goals and objectives and to adjust their program with changes in age, obligations, and financial security.

We are particularly impressed that the options recognize the need for Federal employees to participate in the productivity and earning capacity of the private sector through the fixed income option and, particularly, through the equity investment option.

Over the past 10 years, the owners of all U.S. common stocks have experienced a compounded return of 16.4 percent per year, far in excess of the inflation rate of 7.4 percent. While we cannot assume that such gains will continue in the future, individuals who participated in equity investment options in thrift plans over this period have built up substantial assets to help provide adequate retirement income.

The question I wish to address before this committee is how an equity option might be designed for the proposed Federal employees' thrift plan.

I strongly support the recommendation that an index fund represents the best investment management alternative for the equity fund. Index funds represent a low-cost, fully diversified means to participate in the earning power and capital appreciation of the private sector. In addition, an index fund is the easiest investment management strategy for nonprofessionals to understand and observe.

Over the past 15 years, index funds have grown to over $80 billion in assets, approximately 4 percent of all equity investments. The performance of index funds has been competitive with that of other professional investment managers.

Robert Monks, former Administrator of the Office of Pension and Welfare Benefit Programs at the U.S. Department of Labor, cited our studies in a recent Fortune magazine article when he stated that active management strategies have underperformed indices, and therefore index funds, by up to 1 percent per year. Because of their low costs of administration, management, and trading, index funds have become a standard, long-term equity component of large pension and profit-sharing funds.

An index fund seems particularly appropriate for a Federal employee option because of its impartiality with respect to individual companies. An index fund holds a proportionate number of the outstanding shares of each company or a random sampling of individual companies. The Federal Government thus could easily avoid any implication of favoritism toward any one company or industry.

My firm, Wilshire Associates, has been active for the last 13 years in the development and publication of a variety of new stock market indices, including the widely known Wilshire 5,000 index. We currently manage index funds and also lease the software to run index funds to other managers and in-house managed funds. Against this background, I would like to make some specific comments regarding the language of subsection (b) of section 8427 of the proposed law regarding the design and implementation of the common stock index investment fund.

This subsection empowers the board to define an index which: One, consists of all the common stocks that are publicly listed and traded on one or more national securities exchanges; or two, is a commonly recognized index comprised of common stock at the aggregate market value of at least 50 percent of the total market value of all common stocks that are publicly listed and traded on one or more national securities exchanges.

Point one excludes those stocks that are traded over the counter, including many substantial companies that are traded through the NASDAQ system. Many companies such as Apple Computers and MCI Communications have chosen to remain in the NASDAQ system long after they met the qualifications to be listed on an exchange. We believe that the intent of the proposed law here is to assure market liquidity and open, fair-market pricing. Such objectives can be met without requiring formal exchange listing.

In total, there are more than 3,000 unlisted yet actively traded companies valued at $180 billion representing 9 percent of the aggregate value of all U.S. companies. More importantly, these companies differ in substantive ways from listed companies. As John Naisbitt suggested in Megatrends, the U.S. economy is increasingly oriented toward smaller, less capital intensive and more entrepreneurial companies. Often these emerging companies do not qualify for exchange listing, yet they may represent the economy of the future and better investment prospects.

It should be recognized that these companies are inherently riskier than larger, more established companies. The index fund, however, compensates for individual company risk by diversifying over hundreds, even thousands of companies.

Point two suggests that a commonly recognized index could be adopted as an index fund tracking standard. The most commonly recognized index, the Dow Jones 30 Industrials, is totally inappropriate. It contains only 30 stocks and is weighted according to stock price rather than company size.

Most index funds index to the Standard & Poor's 500 Stock Composite Index. There are several reasons to suggest that the Standard & Poor's 500 index may not be the most appropriate base for the common stock index fund.

The first reason: 500 companies, a leftover from precomputer days, is less than 10 percent of the total number of companies that trade regularly.

Second, the companies selected for the S&P 500 are often the oldest, largest companies in their industry. Newer, faster growing companies and companies in new industries often have to wait for an opening before there is room for them in the arbitrarily limited total of 500 companies.

The industry dispersion of the Standard & Poor's 500 does not agree with that of the broadly based indices. There is a bias toward mature, capital intensive industrial giants. For example, oil companies represent 15 percent of the Standard & Poor's 500 but only 9 percent of the entire U.S. market.

As suggested above, the smaller companies and industries that Naisbitt wrote about are underrepresented in the "smokestack" nature of the S&P 500.

New companies are brought into the S&P 500 by the S&P 500 committee at Standard & Poors. The deletion and insertion of a single company revises the weightings of all other stocks in the index.

No adjustment is made for intra-corporate holdings. During 1984 Shell Oil was carried in the S&P 500 at full weight, even though 99 percent of the shares were held at that time by Royal Dutch Petroleum, a foreign company.

Most importantly, the proportion of the U.S. economy represented by the Standard & Poor's 500 has declined from over 80 percent in 1973 to less than 68 percent today. As the megatrends economy continues, it will become more and more difficult to represent the entire U.S. economy with only 500 stocks.

These problems are not a reflection on the Standard & Poor's 500 as much as they are indicative of the problems faced using any index that comprises less than the totality of the U.S. market.

Subsection (b)(2)(B) of the proposed law mandates that each stock found in the index must be held in the index fund. This is neither practical nor desirable if the number of securities to be indexed is increased. Fortunately, there are widely used sampling techniques that allow index replication without holding each and every issue. The critical difference is between precise tracking of an inaccurate barometer of the U.S. stock markets versus an accurate tracking of a more representative measure.

In conclusion, we would suggest the following changes to the proposed legislation: With respect to subsection (b)(2)(A)(i), provision should be made to incorporate NASDAQ listed over-the-counter stocks.

With respect to subsection (b)(2)(A)(ii), provision should also be made to incorporate NASDAQ listed over-the-counter stocks, and the proportion of stocks represented in the index should be increased from 50 percent to as complete a representation of the U.S. equity markets as reasonably practicable.

With respect to subsection (b)(2)(B), to alter the language to allow the board to permit sampling of stocks in the construction of an index fund.

Mr. Chairman, and members of the committee, I am honored to have had the opportunity to express my views on this proposed legislation. If you have any questions or would like my views on other issues, I am open to questions.

Senator STEVENS. Thank you. We are trying to plan, as I said, for a 30-year period, and your comments are very appropriate that we seem to have sort of put constraints on the investment of the third tier.

We are happy to have your suggestions, but how could we assure that the index we are trying to define for this fund would be representative of a stable market and, at the same time, include these firms that are less well known and, therefore, riskier?

What you are really saying is you have developed an index that can take in these newly developing, highly entrepreneurial companies. How can we generically refer to the indexing system that would assure that the management of the fund would be limited and at the same time take your advice as to broadening it?

Mr. TITO. It turns out, Senator, that the broader indices of the overall stock market are actually less risky since they are more indicative of the overall economy than any index that might represent a subset.

If we went back 75 years and we were proposing an index, I think we would probably come up with a railroad index, because that was the index of the day.

Senator STEVENS. Later, it would have been Dow Jones and then later Standard & Poor's, but you are saying that that is not broad enough now, that there is going to be an evolution between now and 2010, too.

Mr. TITO. Well, the best way to handle that is to have an index or a representation that includes all U.S. equities weighted.

Senator STEVENS. We said it had to represent 50 percent, didn't we?

Mr. TITO. That is right.

Senator STEVENS. Do you think that is too narrow?

Mr. TITO. Much too narrow. It should be representative of the whole market. Computers allow the construction of indices that represent the entire U.S. equity market.

Senator STEVENS. We said at least 50 percent of the aggregate market value of all common stocks listed or traded on one of the national exchanges.

Mr. TITO. That eliminates the NASDAQ-listed securities which represent 90 percent of the market, but more importantly, represent a much more diversified list of emerging companies, and it is those companies that are going to have the largest growth.

So if you are looking for an investment alternative that is going to outpace inflation, you want to go with the part of the U.S. economy that is emerging and growing.

Senator STEVENS. There is nothing that says they can't be individual; it is just that the index must include at least 50 percent of a national exchange.

Mr. TITO. But you do not allow the NASDAQ companies, as the law is presently written.

Senator STEVENS. Because it is not a national exchange, right?

Mr. TITO. That is right. As time goes on, I would project that more and more companies will go for NASDAQ listing as opposed to exchange listing. Over time, you are going to see a larger proportion of the value of common stocks in that segment of the market.

Senator STEVENS. The question really is, is NASDAQ going to survive 30 years, too? It is a listing system rather than exchange, right?

Mr. TITO. Well, there are something like 3,000 stocks traded on NASDAQ and over the counter.

I would raise the opposite question and that is, will there be stock exchanges in the year 2010, or instead, will all securities be traded electronically over a NASDAQ-type system? The NASDAQ system is actually much more competitive than the specialists' system that is represented on the exchanges.

I am saying this as a member of the New York Stock Exchange.

Senator STEVENS. Well, we accept your suggestion, and we look forward to working with you and the colleagues in your area to make certain that we define a system that the board will have to pursue in order to assure the relative safety of these funds, but at the same time, using the state of the art as far as defining how broad it is. And I accept your suggestion that perhaps the broader the spectrum, the safer the investment. It may be that that is the case.

Mr. TITO. One other comment: If you look at the last 10 years, the Government securities returned something like 9.6 percent per year. The Standard & Poor's 500 returned 14.7 percent, and the Wilshire 5,000, which is the aggregate of all stocks, returned 16.4, 14.7 for the Standard & Poor's, 16.4 for the Wilshire 5,000, so you have about seven-tenths of 1 percent greater, over that 10-year period, because small companies typically have done better than the smokestack, large, industrial companies represented in the Standard & Poor's.

Again, I think of the Standard & Poor's today as I would have thought of the railroad index 75 years ago.

I think the point I would like to emphasize is that the maximum potential appreciation and hedge against inflation is made by investing in the entire U.S. economy, not the industrial companies as represented by——

Senator STEVENS. Yes, I understand. It is a good point.

Are IRA's capable of participating in investments according to your plan, the Wilshire 5,000 concept?

Mr. TITO. Not presently. There isn't any mutual fund available. The State of Minnesota has their retirement plan of $1.5 billion invested in a Wilshire 5,000 index fund for the greater appreciation.

But the individual presently does not have that alternative. The best the individual can do is invest in a Standard & Poor's 500 index fund managed by Vanguard.

Senator STEVENS. I was thinking what would happen when they roll out of this retirement plan and want to convert. It would seem that we ought to think ahead and see if that is possible. We wouldn't want their funds in one type of investment and then force them into an entirely different kind of investment upon retirement.

Mr. TITO. I would think that someone retiring would typically move into a fixed-income investment. I think the equity-oriented investment is for someone in their twenties or thirties who are trying to build up some capital over a 20-, 30-, or 40-year period, and once one retires, I don't think an equity investment is all that appropriate.

Senator STEVENS. We appreciate your suggestions and we will call on you for a review of our changes. Thank you very much.

Mr. TITO. Thank you, Mr. Chairman.

Senator STEVENS. The next witnesses are J. Warren Gardner, Susan Z. Holic, and Robert M. Beers from the American Foreign Service Association.

Good morning.

TESTIMONY OF J. WARREN GARDNER, JR., TREASURER, AMERICAN FOREIGN SERVICE ASSOCIATION, ACCOMPANIED BY SUSAN Z. HOLIK, GENERAL COUNSEL, AND ROBERT M. BEERS, CONGRESSIONAL LIAISON OFFICER

Mr. GARDNER. Good morning. The American Foreign Service Association, the professional representative of the career Foreign Service for 61 years, is grateful for the opportunity to appear before your committee to record our views on S. 1527, which establishes a new Federal retirement program for all employees hired since January 1, 1984.

We join with the Department of State in requesting that your committee include the Foreign Service under the Stevens-Roth bill on the assumption that the Foreign Service will be added to the special retirement classes established under the legislation. We wish to express our support for the bill and our willingness to work with your staff to provide a number of technical amendments which will be necessary to bring the Foreign Service under the bill's provisions.

In the Department's testimony before this committee, the Department expresses its concern for the "appreciable number of employees" converting from the Foreign Service to the civil service. In fact, fewer than five employees per year convert from the Foreign Service to the civil service, and it is not those employees with whom our testimony is concerned.

We wish, instead, to bring to this committee's attention to the special concerns of career Foreign Service employees, their retirement rights, and their retirement system.

AFSA is principally concerned with ensuring that Foreign Service employees retain the option of retiring at age 50 with 20 years of service, without reduction in their annuity. Foreign Service employees are unique among Federal Government employees. They are subject to very stringent and specialized requirements for entry into the Service. Once in the Service, their conditions of employment are different.

Foreign Service employees must accept worldwide assignment, with the attendant hazards of living in locations characterized by psychological hardship or physical danger, such as high rates of disease, crime, or terrorist activity. During the past 4 years, 25 American employees have been killed at posts abroad. Indeed, the stresses of Foreign Service life prompted the U.S. Supreme Court to uphold the Department's right to mandatorily retire Foreign Service employees on the basis of age.

The very nature of the Foreign Service personnel system, which attempts to create an extremely competitive career service through the up or out mechanism, makes a career in the Foreign Service especially difficult. Foreign Service employees are subject to two types of mandatory retirement, unrelated to misconduct or their age.

The first is retirement for performing at a relatively lower level than their peers. The second is retirement for failing to receive a promotion within a specified period of time. Congress has, as recently as the Foreign Service Act of 1980, expressed its desire to preserve this vigorous, competitive Foreign Service system. In support of that goal, this committee must assure that this legislation retain for the Foreign Service the option of retirement at age 50 without penalty.

AFSA's additional concern is the maintenance of a distinct Foreign Service retirement system. As early as 1924, the Rogers Act established the Foreign Service retirement and disability system as a separate system from any other Federal retirement plan, administered by the Secretary of State.

Throughout the years, the Department of State has continued to administer the Foreign Service retirement system, financed under a separate Foreign Service retirement and disability trust fund maintained by the Department of the Treasury. This has worked well. Therefore, we ask that this arrangement be retained under the proposed system.

We regret that S. 1527 specifies that the annual cost-of-living adjustments to retirement annuities be fixed at the increase in the Consumer Price Index minus 2 percent. We urge, instead, that Federal retiree COLA's be linked to Social Security cost-of-living adjustments.

There are several other elements of the Foreign Service system, including treatment of reemployed annuitants, election of additional retirement credit for service at unhealthful posts in lieu of post differential, and entitlement of former spouses to share in an employee's annuity, which differ from the civil service system.

We look forward to cooperating with your staff on these matters and assisting in reconciling other differences which may result from the inclusion of the Foreign Service in this legislation.

Again, Mr. Chairman, we believe that this bill offers a significant and desirable program for employees hired after December 1983 and other employees who opt to join the plan. As long as the plan provides for the special concerns of the Foreign Service, we are pleased to support the Stevens-Roth bill. Thank you for allowing us to appear before your committee this morning. We will gladly answer any questions you may have for us.

Senator STEVENS. Under the current law, your people average about 56 when they retire.

Mr. GARDNER. Yes, sir, that is correct.

Senator STEVENS. And they are retiring on the basis of a credit level of, what, about 2.5 percent a year?

Mr. BEERS. Two percent a year, sir.

Senator STEVENS. Two percent a year?

Mr. BEERS. Yes, sir.

Senator STEVENS. We are looking at some specific classes of employees. We have been asked by the law enforcement in the high-risk employees in special types of employment—certainly the Foreign Service is related to those—to look at retirement at age 55 but with a penalty for retirement before 55 of a 2-percent reduction. I take it what you are saying is that since you are subject to mandatory retirement without regard to age for those people who are mandatorily retired prior to 55, they should not be subject to a penalty. Is that what you are saying here?

Mr. GARDNER. Yes, sir.

Senator STEVENS. That seems to make sense. For the person who elects to retire, however, I don't think that we can discriminate between the various types of employees, but a mandatory retirement would be another matter.

Mr. Beers, do you want to comment on that?

Mr. BEERS. Yes, Senator. The other day, when the Department of State was testifying, you raised questions about the number of people who went out in the 1970's. One point that should be made in that connection is that when an employee knows that he is coming up for mandatory retirement for time-in-class or is going to be selected out, many, many times, in fact the majority of times, he will elect voluntarily retirement, so he goes in the records as having voluntarily retired rather than waiting until they took him by the coat and led him out the door.

So those statistics need to be refined in terms of understanding the terms under which people have exited.

Senator STEVENS. Those people weren't primarily below 55, though, were they?

Mr. BEERS. Well, a number of them were. I think the Department is trying to get some statistics together to show how that has worked in recent years since the enactment of the Foreign Service Act of 1980. There have been some changes in that area.

Senator STEVENS. It is difficult to relate your people to some of these. I know you get special compensation for certain assignments, as some law enforcement people get extra compensation for certain assignments.

Mr. GARDNER. Yes, sir, for good reason. We have on our records the fact that at least 50 percent, 56 percent, of our posts overseas are classified as a hardship post, thus subject to a hardship differential.

Senator **Stevens**. I understand that. But you are dealing with people who get travel allowances and get housing allowances; they get a lot of things. And, upon retirement, to then have a special category when they return home after having been compensated for those hardships, that is going to be tough to write into a retirement bill, I think, and still be fair to the people who spend 30 years here in Washington, DC, and they are subject to about the same kind of hardship, in my opinion, as you get in most foreign posts. [Laughter.]

Mr. **Gardner**. Allowances notwithstanding, the fact of the matter is that life in an overseas post is hazardous to one's health. In fact, after age 50, some 60 percent of our Foreign Service personnel and their families do not have full medical clearance. Between the ages of 46 and 50, as much as half of these personnel do not have full medical clearance for themselves and their families.

Senator **Stevens**. By definition, retirement for medical reasons is in a different category.

What you are really saying is you want to have a different category by virtue of the fact that your people have served overseas a considerable portion of time. We are just going to have to take a look at that. As a matter of fact, some Foreign Service officers never go overseas, but they are still Foreign Service officers. Isn't that right?

Mr. **Gardner**. No longer. There is wear and tear on people serving overseas. There is psychological stress in addition to just general hazards.

Senator **Stevens**. You ought to join me in a conference committee once in awhile if you want to talk about wear and tear. [Laughter.]

You have got a problem. I don't know; maybe we should put you in the military retirement system, because that would be more comparable, really. What you are saying is you are more comparable to the military service than civilian service.

Mr. **Gardner**. Actually, our retirement system was structured around the original naval retirement system.

Senator **Stevens**. I am not sure you are going to want to be in the naval system. We hear you. We will see what we can do and be in touch with you about it. I am certain we will consult with the Foreign Relations Committee and see what their desires are with regard to this system.

How many people are we talking about in the Foreign Service?

Mr. **Gardner**. In the Foreign Service? Well, from my association standpoint, we represent 9,000 employees at the moment.

Senator **Stevens**. But how many people are we talking about in the overall coverage of Foreign Service?

Mr. **Gardner**. 12,000.

Senator **Stevens**. We will meet most of your objectives, I think. I understand your problems. I don't think we can make any special category as far as the COLA consideration is concerned, but I think we can meet your objectives concerning mandatory retirement and premature retirement to carry forward the options that you have had under the Foreign Service Act now.

As far as maintaining a separate retirement system, that we will have to look at in terms of whether we can do it financially. Mr. Cowen tells me that we have worked out some arrangement with State. Are you familiar with that?

Mr. BEERS. I believe the understanding is coming up. I am not sure it is finalized. But the important aspect of that, Senator, is that the administration of the program remain in the Department. I think the question related to where the trust fund would be located, and you or someone made a suggestion that part of the civil service retirement disability trust fund be earmarked or, in the bookkeeping sense, be set aside for Foreign Service. That question, I think, is of secondary importance to the importance of the administration of the Foreign Service retirement program remaining in the State Department.

Senator STEVENS. Your goal is to put all these funds in one. The old plan, the new plan, all the people covered under this would be under the same system so that management costs are reduced. I think that we can meet your objectives, and we would be happy to work with you and the State Department.

I don't have any questions. I think that you do have some difficult problems. Certainly what is going on in Moscow recently demonstrates that. So we will take heed of your testimony and do our best to accommodate your request.

Mr. GARDNER. Thank you.

Mr. BEERS. Thank you, sir.

Senator STEVENS. Thank you very much.

[Mr. Gardner's prepared statement follows:]

American Foreign Service Association

STATEMENT OF J. WARREN GARDNER, JR., TREASURER
AMERICAN FOREIGN SERVICE ASSOCIATION
BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

CONCERNING S.1527,
THE CIVIL SERVICE PENSION REFORM ACT

September 11, 1985

The American Foreign Service Association, the professional representative of the career foreign service for sixty-one years, is grateful for the opportunity to appear before your Committee to record our views on S. 1527, which establishes a new federal retirement program for all employees hired since January 1, 1984.

We join with the Department of State in requesting that your Committee include the Foreign Service under the Stevens-Roth bill, on the assumption that the Foreign Service will be added to the special retirement classes established under the legislation. We wish to express our support for the bill, and our willingness to work with your staff to provide a number of technical amendments which will be necessary to bring the Foreign Service under the bill's provisions.

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In the Department's testimony before this Committee, the Department expresses its concern for the "appreciable number of employees" converting from the Foreign Service to the Civil Service. In fact, fewer than five employees per year convert from the Foreign Service to the Civil Service, and it is not those employees with whom our testimony is concerned. We wish instead to bring to this Committee's attention the special concerns of career foreign service employees, their retirement rights, and their retirement system.

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AFSA's additional concern is the maintenance of a distinct Foreign Service retirement system. As early as 1924, the Rogers Act established the Foreign Service retirement and disability system as a separate system from any other federal retirement plan, administered by the Secretary of State. Throughout the years, the Department of State has continued to administer the Foreign Service retirement system, financed under a separate Foreign Service Retirement and Disability Trust Fund maintained by the Department of the Treasury. This has worked well. Therefore, we ask that this arrangement be retained under the proposed system.

We regret that S. 1527 specifies that the annual cost of living adjustments to retirement annuities be fixed at the increase in the Consumer Price Index minus two percent. We urge instead that federal retiree COLA's be linked to social security cost of living adjustments.

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Again, Mr. Chairman, we believe that this bill offers a significant and desirable program for employees hired after December 1983 and other employees who opt to join the plan. As long as the special concerns of the Foreign Service are provided for, we are pleased to support the Stevens-Roth bill.

Senator **Stevens**. Stanford G. Ross of Arnold & Porter.

I want to thank you, Mr. Ross, for agreeing to contribute to our study and for your efforts in assisting us in this regard. We commend you and your firm to do this as a matter of public service, and we thank you.

TESTIMONY OF STANFORD G. ROSS, ARNOLD & PORTER

Mr. Ross. Thank you, Senator Stevens. We appreciate the opportunity to be here and contribute what we have learned from our experience to your endeavor.

Mr. Berger and I have had a lot of private pension experience, and I have had a great deal of public experience with pension matters, and the statement that we are putting into the record reflects the matters we think should be considered further.

I am going to concentrate this morning on just making a few remarks related to some major issues with the thrift fund investment management system that is contained in the bill, and our remarks are reflective of our experience with these concepts in the ERISA area.

In general, we think the proposed bill has done a good job of adapting the regulatory pattern in the private sector to the Federal employee context, which is, in many respects, unique and different. The issue as we see it is further refinement of some of the particular provisions that you already have in the bill. We would be happy to work with you and your staff as you go forward on your work.

Our first point would be whether the thrift board and its members should be treated as technical fiduciaries, which could lead to the courts rather than the Congress and the executive branch being the ultimate arbiters of policy matters and political issues in some circumstances.

Our belief is that policy issues can best be dealt with in the political arena by Congress and the executive branch and that while all public servants, including those on the thrift board, should be accountable under appropriate standards of conduct, treating thrift board members as fiduciaries would not really advance this end.

I think back here to my experience, when I was Commissioner of Social Security, with the trustees of the system who were the Secretaries of HEW—in those days, Treasury, and Labor. As the Commissioner, I brought them in on the report. They spent relatively little time in issuing the trust fund report, which was sent to Congress, because these were high policy officials.

If they had been classified as technical fiduciaries in the ERISA sense, given the problems of shortfall that we have had over the years in the Social Security funds, you would have had all kinds of litigation as to whether they had exhibited the kinds of expertise which are required of technical fiduciaries.

This doesn't mean that they shouldn't be held accountable as prudent Secretaries, and the Federal Reserve Board Chairman who is going to serve on the thrift board should certainly be accountable to spend enough time in the policy sense to do a good job.

But we do think that treating them as technical fiduciaries is likely to interject the courts and the court system too deeply into political issues that would be better addressed by congressional oversight.

Second, and it is a similar point, we think that the responsibilities of those persons who should be treated technically as fiduciaries should be made more explicit, including making provision for respective responsibilities of cofiduciaries, as is done in the ERISA area. We think accountability will be stronger if the particular fiduciary's responsibilities are more precisely defined for the various people that will be in the chain having investment authority.

Senator STEVENS. We accept your point there that although they are policy officials and will be in the line of receiving some very volatile information as far as the market is concerned, they are not fiduciaries. Do you think the mere fact that they serve in their other positions would be sufficient as far as imposing upon them the duties of fiduciaries?

Mr. ROSS. No. I think I would put in a standard of conduct for them in this capacity. The Chairman of the Federal Reserve Board already receives a lot of highly confidential, important information, but he is not a technical fiduciary in the ERISA sense for the U.S. monetary system.

I think your point is well taken. There should be standards; I just think they just can't be incorporated en blanc from the ERISA area. That is my point.

Senator STEVENS. I will ask my staff to work with you to try and deal with that. Your point about cofiduciaries is correct. I remember that section in ERISA.

Mr. ROSS. That is an important concept, because there may well be more than one person liable if there is some defalcation or something similar.

Another area we think you ought to spend a little more time on is the statutory standards governing the need for active decisionmaking. The statute implies that active decisionmaking either will not or should not take place, which we would say, based on our experience, is unrealistic.

In ERISA, this is a highly controversial area, but in many contexts, if you own common stocks for example, or if you have to decide what fixed income securities to invest in, there will be active decisionmaking, and what is needed in the bill are some practical procedures that will help avoid controversy and not hamstring the system, because you will get litigation every time somebody is unhappy with the kind of active decisionmaking that is made.

I point out in the testimony here that if there is a proxy filed, for example, if you are a shareholder, you can't really sit back and say, well, we won't vote, because if the allegation is that the fight is because there has been mismanagement and you don't vote, that is a vote for management usually. So that what is often done in the private sector is simply to say that the voting rights of the stock will be passed through to the participants. Whether that is feasible in this context would require further consideration.

Senator STEVENS. I don't see how it could be, do you?

Mr. ROSS. Well, it is so big, yes. If it is too big, I don't see quite how you can do it, right.

Senator STEVENS. But you could have a board of representatives——

Mr. ROSS [interposing]. Representatives, yes.

Senator STEVENS [continuing]. Representatives of the participants who could exercise the voting rights.

Mr. ROSS. But somehow that area requires, I believe, a little more work, because the statute implies that you just don't do active decisionmaking and, of course, that is not possible; a failure to vote is a vote, which often happens in the shareholder area.

Senator STEVENS. We will look into that one, too. I think that is a good criticism. It would be hard, in some instances, to identify the people who really have a direct interest in the investments. But I think we just have to have a group who represent employees as a whole who would make those kinds of decisions rather than the statutory officers, who are really just overseers, or the executive director. That would be too much for one person.

Mr. ROSS. Yes. I think he could become a very powerful figure if he controlled all the votes every time there is a corporate takeover attempt and a lot of the stock is in that fund. I don't think he would like that, either, given the sensitivity that that position will embody.

Another point which we think could require a little clarification is the statutory provision that says investments should have broad acceptance by participants and the public. As you know, in the private area, there has been a great deal of comment and controversy in recent years over the concept of social investing; that is, investing where you look at things other than sheer economical calculations, of rates of return, profit, risk, et cetera.

We think that the language suggests there may well be some social investing ideas here, and if that is so, then I think you need more practical guidelines. Otherwise, you are going to wind up with issues such as whether you should invest in any stocks that——

Senator STEVENS [interposing]. Do you intepret this bill as pointing toward a social investment concept?

Mr. ROSS. I do; but it is at least ambiguous.

Senator STEVENS. We will straighten that out. I don't think that should be our function.

Mr. ROSS. It may be hard to avoid the notion when you say that it should have broad public acceptance, for example, and I think you may want some social investing in some ways; I don't know. I don't know what the intent was here.

Senator STEVENS. I don't think we should mandate the use of employee investments in social schemes. That should be up to some professional management.

Mr. ROSS. Right. So you would go more toward a strict economic investment.

Senator STEVENS. Right.

Mr. ROSS. Then the language could be clarified.

Senator STEVENS. We would be happy to have your suggestions. If you read that in there, that was not intended.

Mr. ROSS. OK. Last, another point in this area is that we think the rights of employees to the courts with respect to the rights and benefits should be broad, as it is in ERISA; maybe a little broader than the present bill implies, while at the same time they should not have a right to litigate what are essentially policy or political issues which should be brought back to the Congress during oversight hearings.

We think that is an area that can be refined a bit, too.

Senator STEVENS. They certainly are not stockholders in the sense of the norm, though. We want to avoid that.

Mr. ROSS. That is right.

Senator STEVENS. We would be happy to have your help there, too.

Mr. ROSS. OK. Thank you.

One last point that I would note is that our general feeling is that you are correct in designing a bill where Federal employees and persons in the private sector should be treated as much alike as possible. From that standpoint, we would suggest that lodging administration of this part of the bill in the Department of Labor, which has responsibility with respect to private-sector plans, may be desirable to get uniformity of interpretation.

We are afraid that if the Justice Department were to do it, you would have two competing agencies interpreting similar provisions, and it may well be that the kind of equality of treatment that you are looking for would be harder to achieve.

There is another point like this, which we did not address in the testimony.

Senator STEVENS. Maybe it reflects sort of a feeling about the Department of Labor in the past few years, but I think you are right. The uniformity would be there.

Mr. ROSS. Right. I am not sure I would say they have always done a job that couldn't be questioned.

On the other hand, having served in several Government agencies in my day, that is true of almost any controversial area, and if you have one agency interpreting similar provisions, at least you know whose door to go knock on.

Senator STEVENS. You are right. We will adjust that. We won't need any help on that. We will adjust that there. You are right.

Mr. ROSS. Another point which is not in the testimony but in this morning's headlines, so I thought I would mention it, is, you need to think about mechanisms to keep comparability. For example, the administration has now proposed eliminating 401(k) plans from the private sector. I don't know that that is going to happen, but surely, if there is a tax bill, and I assume there will be, the 401(k) area will be changed.

Aspects of the thrift plan, of course, resemble 401(k) and IRA type provisions and others.

Somehow, the tax treatment accorded Federal employees should be the same as that accorded, roughly, private employees; and yet, does this mean that every time there is a tax bill you will simply have to score through all of this? What are the mechanisms so that the equality of treatment in an important area like taxation is kept the same, and you don't put in a scheme which, over the years, because, say, the tax benefits are greater for the public employee than the private employee, it once again begins to be perceived by the general public as simply too good a thing, which they don't get to participate in?

Senator STEVENS. We tried to avoid that by just tying into the 401(k), tying into the systems that are there, so that if there are changes in those systems, public employees will be affected the same as anyone in the private sector.

Mr. ROSS. The bill leans in that direction, but I think you could make that a little clearer with some additional provisions. We would be glad to work with your staff on that.

Senator STEVENS. We would be glad to have that advice, although with regard to the 401(k), if the 401(k) does suffer a demise, I still think we could create a Federal employer/employee concept that would involve matching and some other things which would not be tied into a 401(k).

Mr. ROSS. I think you could. I am sure in the private sector there will be plans, even without 401(k). There were thrift plans before it, and there will be thrift plans even if it were to go. I mean, the concept of a thrift plan is a very sound basis for retirement planning in all events. It is just a question of how much tax benefits go with it.

Senator STEVENS. The inducement to save can survive without regard to tax considerations.

Mr. ROSS. Yes. I think the concept of a thrift plan as a third layer in your bill is very good, very strong, and you have done a great deal of, obviously, careful and good work. We think, in general, it is a very sound approach.

Senator STEVENS. We thank you very much. My good right arm here will be back in touch with you about some of the details.

Mr. ROSS. Thank you for the chance to be here today.

Senator STEVENS. We appreciate your details. They are very valid. I look forward to your reviewing our final draft. If something slips through it, we would appreciate your bringing it to our attention.

Mr. ROSS. We would be happy to do that.

Senator STEVENS. Thank you very much.

[Mr. Ross' prepared statement follows:]

STATEMENT BY
STANFORD G. ROSS
and
PAUL S. BERGER

BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

September 11, 1985

We are pleased to be invited to contribute to your study of Senate Bill 1527, the Civil Service Pension Reform Act, introduced July 30, 1985 by Senators Roth and Stevens. We commend your efforts to develop a Civil Service Pension System for federal workers participating in the Social Security system. The proposed Bill conscientiously seeks to contribute to the important goal of providing a sound retirement income security program for federal workers. The proposed Civil Service Pension System reflects careful consideration of the many components needed to construct such a program, including the roles of Social Security, employer-sponsored programs, individual savings programs, regulation and taxation.

You have asked us to comment specifically at this hearing on those provisions of the proposed Bill relating to the Thrift Fund. The Thrift Fund will be composed of employee and federal government contributions that require prudent investment management. The proposed Bill contains provisions for the creation of a Thrift Board, fiduciary responsibilities for those persons involved in management of funds, prohibited practices and enforcement mechanisms.

We are making this statement in our individual capacities to present our personal views as to the public interest in these matters. We are currently partners in the law firm of Arnold & Porter, Washington, D. C. We both have substantial experience with employee benefit matters and have practiced, lectured and written extensively in this field. Mr. Ross served as Commissioner of Social Security during tne period 1978-1979.

As the Congress determined in passing the Employee Retirement Income Security Act of 1974, a comprehensive framework for a sound and stable pension program must include provisions for accountable management, standards of conduct and responsibility for fiduciaries, and appropriate sanctions, remedies and access to federal courts. The proposed Bill incorporates a number of the concepts embodied in ERISA regarding fiduciaries and enforcement. The provisions of the proposed Bill reflect an admirable job of adapting those concepts to a plan for federal workers, a plan that is different in some respects from plans maintained by private employers and other public employers. The thrust of the Bill's provisions for a Thrift Investment Management System clearly promotes the goals of soundness, stability and accountability for the pension program. The issue as we see it is refining the proposed provisions so that they best achieve their goals.

Fiduciaries

1. The Thrift Board

The Thrift Board is to be composed of the Chairman of the Federal Reserve Board, the Secretary of the Treasury, the Director of the Office of Personnel Management and two presidential appointees that will be representatives from federal employee organizations: one from a labor organization and one from an organization for employees who are managers. The Board is to have broad and important responsibilities to establish policies and prescribe regulations for investment and management of the Thrift Savings Fund, for the administration of the Fund, for direction, supervision and performance evaluation of the Executive Director, and for the review of investment performance. The Board is expressly prohibited from directing the Executive Director or any investment manager or other fiduciary to make a specific investment or disposition. The definition of the term "fiduciary" expressly includes the members of the Board.

The Board should execute its responsibilities in accordance with appropriate standards for accountability; however, the enforcement provisions permit civil actions by a number of interested parties for injunctions or other equitable relief in conjunction with the breach of fiduciary duties. Thus, the Board would seem subject to civil actions in connection with its authority to establish policy, prescribe regulations, appoint and oversee the Executive Director and Advisory Committee and other authority. This could lead to the federal courts being the ultimate arbiters of these matters which essentially deal with policy matters and to some extent political issues.

Thus, it is not clear that it is desirable for members of the Thrift Board to have the status of fiduciaries with respect to the Thrift Savings Fund. Although the Thrift Board should be accountable with respect to its actions in executing its broad authority to set policy for the investment and management of the Fund and the administration of the Bill's provisions relating to the Thrift Savings Plan, it may not be productive to make the Board seem accountable through the enforcement mechanisms designed to be applicable to the fiduciaries that will implement those policies.

The Board will not be responsible for the specific transactions of the Fund that need to be scrutinized under the prohibited transaction provisions, including provisions prohibiting certain transactions with parties in interest or certain transactions giving rise to self-dealing by fiduciaries. However, the broad language of the provisions relating to the discharging of fiduciary responsibilities solely in the interest of the participants and exclusively for their benefit, and with the skill and prudence of experts, would apply to the execution of the Board's authority if the members of the Board are designated fiduciaries.

Another approach that could be considered, assuming it is deemed desirable to designate the members of the Board as fiduciaries, is to limit civil suits by participants so that the forum for resolution of potential controversies over policy matters and political issues is not the court system, but the legislative process.

The Board's accountability with respect to its duties under the Bill will normally be achieved in the legislative arena. The Congressional committees charged with the responsibility of overseeing the Board's execution of its duties may provide an effective, yet not disruptive, forum for the communication by interested parties of their concerns. Congressional oversight is inevitable in any event, given the inherent conflict resulting from the primary enforcement responsibility under the Bill being in a department of the executive branch while primary management responsibility under the Bill will be in a group composed of other members of the executive branch.

In sum, we urge further consideration be given to the anticipated future roles of the executive branch, Congress and the courts with respect to policy matters and political issues that arise out of implementation of the new system.

2. Other Fiduciaries

Only the members of the Thrift Board and the Executive Director are expressly named as fiduciaries with respect to the Thrift Savings Fund. Other parties will have fiduciary status by reference to the definition in ERISA section 3(21)(A), based on persons having discretion or control with respect to assets, investments or administration.

It might be appropriate to name the members of the Advisory Committee as fiduciaries and to identify the persons who will perform specific management functions as fiduciaries and to define specifically the extent of their respective responsibilities as fiduciaries. By taking these added steps, it can be made clear to what extent and with respect to what functions or assets such persons are subject to the fiduciary provisions. Although such clarification would neither expand nor contract what we think is the intended coverage of the provisions, it could serve to prevent controversy and needless litigation.

The Bill does not explicitly provide for co-fiduciary liability, an omission that, given the explicit liability set forth in ERISA, might suggest that co-fiduciaries are not liable here. We see no reason not to include in the Bill a provision similar to ERISA section 405, providing the basis for co-fiduciary liability.

Because the chains of authority and responsibility could become quite complex in the operation of the Thrift Savings Plan and Fund, the additional clarification of the scope of the fiduciary duties of various persons could serve as notice to the various fiduciaries of their relative responsibilities and could better define the scope of scrutiny at each level. Furthermore, the diversification requirement imposed on investment decisions would be susceptible to clarification in accordance with the clarification of the chain of authority and specific responsibilities of designated parties in the chain.

3. Bonding and Insurance

The Bill contemplates that a number of fiduciaries will exercise custody or control over funds in the Thrift Fund. For the protection of participants in private sector plans, ERISA section 412 requires that fiduciaries and others be bonded. Consideration should be given to imposing bonding requirements on those who will handle monies or property of the Fund, with provision for administrative exemption from or modification of the requirements similar to those set forth in ERISA section 412(e).

ERISA section 410(b) permits private sector plans to purchase insurance for liability or losses from fiduciary breaches only if the insurance permits recourse by the insurer against the fiduciary. Fiduciaries are permitted to purchase liability insurance for their own accounts. In addition, employers and employee organizations are permitted to purchase insurance to cover fiduciaries. Often, in the private sector, employers sponsoring plans purchase insurance to cover fiduciaries or indemnify fiduciaries. In many cases, such insurance or indemnification is a condition of obtaining the services of such fiduciaries.

It may be desirable to expressly permit the Executive Director to enter into arrangements that include the purchase of insurance or other means of reducing the exposure or risk of certain contractors, in order to provide the Executive Director with a greater measure of flexibility in securing private sector services. If insurance is permitted, however, care should be taken that the Thrift Savings Fund, itself, does not bear the costs of these arrangements. In general, there may be considerable benefit to taking more detailed account of private sector experience in these matters.

Investment Policy

1. Active Investment Decisionmaking

The Bill provides guidelines for the establishment of investment policies by the Thrift Board. One such guideline directs the Board to develop policies that provide for "investment strategies which do not require a significant level of active investment decisionmaking in the case of" the Fixed Income Investment Fund and the Common Stock Investment Fund. The Board, itself, is precluded from directing the Executive Director or any investment managers or other fiduciaries to make specific investments or dispositions. While we can well understand the sentiments that underlie these provisions, it may be wise at this point to anticipate some likely areas of problems as the system is implemented.

In the case of the Fixed Income Investment Fund, under which funds are to be invested in insurance contracts, certificates of deposit or other fixed income instruments or obligations, active investment decisionmaking will be necessary on the part of investment managers if such fiduciaries are to be permitted flexibility in considering risk and return and in diversifying the investments of the Fund. The Board may find it desirable to establish policies or prescribe regulations that guide investment managers of the Fixed Income Investment Fund. Thus, the intent of the guideline regarding active investment decisionmaking should be clarified with respect to this specific Fund since it appears inconsistent with the realities of prudent investment management of such assets.

In the case of the Common Stock Index Investment Fund, active investment decisionmaking will not be necessary with respect to the choice of common stocks, because the Board is directed to define an index that either consists of all public stocks or is a commonly recognized index meeting certain requirements.

The Common Stock Investment Fund, however, will invest in stock carrying voting and other rights with respect to which, in the exercise of their fiduciary duties, the Fund managers will be required to engage in a significant amount of active decisionmaking, like any prudent shareholder. In this regard, it should be recognized that in many contexts the failure to make a decision or to take an action may itself be an action with serious consequences to contending parties. Thus, there may be no way in many contexts to avoid active decisionmaking.

The experience under ERISA has included a great deal of controversy over the duties of fiduciaries with respect to stock investments. Those duties are not clear and, in many cases, in an effort to relieve the fiduciaries to the extent possible of the complex duties, private employer-sponsored plans have provided that voting rights be passed through to participants. The extent of the duties of a fiduciary under ERISA to monitor corporations and to determine whether a plan-shareholder should bring actions for breaches of corporate fiduciary duties is not a well-settled issue under ERISA.

It would seem desirable to consider these issues that have arisen with private sector plans and to define the duties of fiduciaries with respect to the Common Stock Index Investment Fund in the statutory framework in a practicable manner that will help avoid controversy and needless litigation.

2. Broad Acceptance of Investments

Another guideline for the Thrift Board's establishment of investment policy directs the Board to develop policies that will provide for "investments likely to receive broad acceptance by participants and the public." While the sentiment that underlies this guideline is understandable, the legislative language here is extremely vague and almost certain to breed continuous controversy. For example, it would seem that under this provision the Board is entitled to establish policies that reflect to some extent "social investing."

There has been a great deal of discussion in the past several years in the context of investment policy for private sector employee plans over the extent to which plans should be permitted to make investment decisions on the basis of social factors, as opposed to purely economic calculations. For example, the Department of Labor has taken the position that a plan is not entitled to take account of the job-creating aspect of investment decisions. Commentators are divided as to whether under ERISA fiduciary decisions on investment alternatives may be based in part on such social concerns as the environment or political preferences, as opposed to solely on economic factors, such as risk management, diversification and maximization of return.

If the goal of this aspect of the legislation is to provide guidance on "social investing" in the management of the Thrift Savings Fund, then the statutory provision should be more explicit. If some other goal is intended, the provision still appears to need clarification, preferably in the statute, but also in legislative history.

Unfortunately, as you undertake this task, the private sector experience, while rich in the elucidation of controversial issues, is poor in finding broadly acceptable solutions. This area initially may be controversial, but at least the issues should be focused in terms that allow resolution without undue controversy and needless litigation.

Prohibited Transactions

1. Parties in Interest

The definition of "parties in interest" under the Bill only adapts parts of the definition provided in ERISA section 3(14). The only omitted provision in the ERISA definition that, arguably, should be considered for inclusion in the Bill's definition is the provision defining "parties in interest" to include employees, officers, directors and 10 percent or more shareholders of persons that are parties in interest under other parts of the definition. Because the Thrift Savings Fund will be employing persons from the private sector and making investments in private sector entities and instruments, it may be appropriate to expand the definition of "parties in interest" to include persons described in ERISA section 3(14)(H).

2. Adequate Consideration

The provisions of the Bill relating to transactions with parties in interest, unlike the corresponding ERISA provisions, do not flatly prohibit virtually all transactions with such persons. ERISA provides statutory exemptions and a procedure for administrative exemption, and was purposefully overinclusive in its efforts to protect the soundness and stability of plans. However, the "escape valve" of the administrative exemption procedure has been thought by some to be overly cumbersome.

The Bill, by contrast, would prohibit transactions with parties in interest, except when adequate consideration is exchanged. This corresponds more closely to the pre-ERISA common law standard that was regarded by some as too elusive for effective enforcement. The determination of "adequate consideration" often raises issues of fact with respect to which reasonable people might differ. Congress may believe, however, that governmental fiduciaries need not be constrained by the strict ERISA rules.

In any event, consideration might be given to defining the term "adequate consideration." Guidance might be provided, for example, by way of specific substantive definitions in certain classes of transactions, such as transactions in commonly traded assets where comparable prices are available. Also, specific procedures might be outlined that, if followed, create a presumption that consideration is adequate, for example, obtaining independent appraisals or providing competitive bidding processes. The goal here should be to expedite investment decisions rather than to complicate such decisions because of vague requirements.

3. Fiduciary Self-Dealing

The fiduciary self-dealing provisions closely track the language in ERISA section 406(b); however, for no apparent reason, the Bill's provisions are not precisely the same as ERISA sections 406(b)(1) and (b)(2). The Thrift Savings Fund will operate in the private sector to a significant extent, and it would seem appropriate that the applicable self-dealing provisions be identical with those in ERISA to that extent.

4. Interpretation of Statutory Provisions

Because the fiduciary responsibility provisions of the Bill incorporate many concepts from ERISA, with some modifications, it may be appropriate to consider whether provisions should be included in the Bill or legislative history expressly directing that precedents under ERISA will apply to the Bill, or pointing out that, with respect to certain provisions, specific changes from ERISA were or were not intended. It might be appropriate to include discussion of these matters more specifically in legislative history materials, so that the intent of Congress is set forth on the extent to which ERISA and related authority is or is not to be followed.

Enforcement

1. Attorney General

The Bill places primary responsibility for enforcement of the fiduciary provisions with the Attorney General of the United States. For over a decade, the Department of Labor has developed the resources, expertise and procedures for enforcing very similar provisions of ERISA. It should be considered whether efficiency and effectiveness would be better served by placing enforcement responsibility under the Bill with the Department of Labor. Greater consistency of treatment in dealing with interpretive problems would surely be achieved if a single agency had responsibility for such functions with respect to ERISA and the proposed Bill.

2. Suits by Participants

The provisions for enforcement limit civil suits by participants to actions to enjoin violations and to obtain other appropriate equitable relief to redress violations. Under ERISA participants have access to court for disputes as to benefits and rights under a plan. Participants in the Civil Service Pension System should have some forum for resolution of disputes as to benefits and rights. Participants should be able to resort to courts whenever disputes with the administrators involve interpretations of the law and regulations.

In closing, let us commend the Committee for its important work on this subject. You are well on the way to designing the kind of regulatory provisions that are necessary to implementation of the new pension system for federal workers. Refinement of the statute and added legislative history should help you to achieve your goals in this area. If there is any way that we can contribute further to your work, we will be pleased to so do and would urge you and your staff to call upon us. We thank you for inviting us here today.

Senator STEVENS. Next we have Hastings Keith and John Macy, cochairmen of the National Committee on Public Employee Pension Systems, accompanied by William O'Reilly.

Good morning, gentlemen. This is the final panel for this series of witnesses. There is no comment I could make concerning the adequacy of this one, but I understand your direct interest in this. We look forward to receiving your advice. It is a good panel to wind up with in view of the obvious overlapping interests of some of us who are getting nearer and nearer to your situation now. We appreciate the time you are putting into this in looking over the program. We would be happy to have your comments.

TESTIMONY OF JOHN W. MACY, JR., AND HASTINGS KEITH, COCHAIRMEN, NATIONAL COMMITTEE ON PUBLIC EMPLOYEE PENSION SYSTEMS, ACCOMPANIED BY WILLIAM O'REILLY, TREASURER, PEPS

Mr. MACY. Thank you, Mr. Chairman. We appreciate being either the anchor witnesses or the final ending witnesses.

We are grateful to you and the members of the committee for affording this particular group an opportunity to express itself at this particular time.

I believe that we can be most helpful in the time available if we cite the areas where we believe there needs to be modifications or additions to the plan that you and Senator Roth introduced.

As a consequence, I would like to open up in the middle of page 2 of the testimony. The previous information is largely a background with respect to our committee, and I am sure you are familiar with that. That can stand in the record.

Senator STEVENS. I am familiar not only with your committee, but with each of you personally, so I am pleased to have your assistance.

Mr. MACY. Thank you, sir.

Our committee compliments you and Senator Roth as sponsors of S. 1527 for your initiative in introducing legislation that moves meaningfully toward redressing those aspects of the Federal pension system targeted by the Brookings study some time ago, which is quoted in the previous paragraph; namely, increasing the age for unreduced benefits, reducing the level of future benefits, and partially, rather than fully, indexing for inflation.

However desirable as those steps are, they do not, in our view, go far enough to meet the critical problems of inequity and unaffordability that plague the present Federal civil and military pension systems. We believe that S. 1527 needs to be strengthened in several respects.

First, the normal retirement age should be increased to coincide with that of the Social Security system, namely, 65 initially and higher in later decades.

Second, the factor multiplier for years of service should be reduced from 1 percent to 0.5 percent for years of service beyond 30.

Third, the actuarial reduction for early retirement should be increased to 6 percent annually for all voluntary retirements below age 62, and a reduction of 3 percent annually should be imposed for the period 62 to 65.

Fourth, the cost-of-living allowance provision should be changed to index only that portion of total Federal benefits, including Social Security, which is equal to the Social Security maximum benefit, with amounts beyond that unindexed.

Fifth, present employees not approaching retirement age, for example, under age 45, should be brought into the new system with benefits prorated according to length of service in the old and new systems respectively.

Sixth, future pension payments made to retirees and survivors should fully or partially exclude the 1-percent kicker, which was in effect from 1969 to 1976, from the calculations base.

Seventh, double counting of military service for both civil service and military retirement purposes should be prohibited.

Finally, projected Treasury revenue losses arising from exclusion from gross income of employee and employer contributions to the proposed thrift plan should be calculated, and such loss should be included in computing costs of the new system in comparison to the present system.

I would like to elaborate, if I may, Mr. Chairman, on these several points.

First of all, with respect to normal retirement age and actuarial reductions, we propose that the normal retirement age for the new system be 65 initially, with future increases as mandated by the Social Security Amendments of 1983, and with early retirement subject to a 3-percent reduction for each year age 62 to 65 and a 6-percent reduction for each year age 55 to 62. In contrast to current high rates, this represents a low rate of early retirement subsidization. That is, full actuarial reduction at 55 would be 60 percent in comparison to our proposed 51 percent, which is 7 times 6 percent plus 3 times 3 percent.

We question the approach taken in S. 1527, whereby the normal retirement age is pegged at 62 rather than 65 and whereby actuarial reductions are tied to whether or not the retiring employee has 30 years of service. This can create frequent "notch problems." More important, with continuing dramatic increases in life expectancy, it is fiscally unrealistic, in our view, to provide full benefits below the Social Security retirement age. We believe that the 5-percent reduction below age 62 specified in S. 1527 for retiring employees with less than 30 years' service should be extended to all voluntary early retirements and be increased to 6 percent, with annual reductions of 3 percent for those retiring employees between ages 62 and 65.

In the cost-of-living adjustments, we propose no cost-of-living adjustment for the supplemental benefit for so long as the Social Security benefit is fully indexed. For present retirees, we have for several years urged a capping of civil service and military cost-of-living allowances at the level of maximum Social Security benefits, approximately $10,000 annually. This approach is much more equitable and adequate for those on lower retirement incomes than by simply adopting a formula such as CPI minus 2 as provided in S. 1527.

A major portion of your legislation relates to the thrift savings plan. We have comments on that.

As shown in the appended "Essential Components of a Supplemental Retirement Plan" for post-1983 Federal hires, our committee states under point XII.

> The foregoing plan components provide adequate retirement income for the Federal retiree. Consequently, the committee believes a Government-financed supplemental thrift/savings plan is not required.

The committee recognizes that such plans are a growing part of the pension plans of larger corporations and are particularly attractive to those in high income tax brackets because of the sheltering aspects. As we all know, sheltering of retirement contributions, especially employer contributions thereto, is an important and controversial item in the tax reform bills under consideration by the Congress at the present time.

The 1983 survey of top 50 firms by the Wyatt Co. showed that 39 of the firms had thrift/savings plans involving employer contributions, but with a few of these in "temporary suspension," presumably recession related.

This is from the Wyatt Co. top 50, exhibit 6A, "Thrift/Savings Plans Covering Salaried Employees of 50 Large Industrial Companies," pages 76 to 79. In only 13 of the 39 did employer contributions fully equal or more than equal those of employees. In all of the 39 firms, employee contributions eligible for matching were limited to a specific percentage of basic pay, and only a few of the 39 plans provided for immediate vesting of employer contributions. These and other conditions reduce the overall large firm average cost to under 2 percent of payroll. Stock option, employee ownership, and profit sharing, being considerably more concentrated in fewer employees, produce a total capital accumulation plan total cost of approximately 2 percent of payroll in the larger private sector firms.

We believe, Mr. Chairman, that before including any thrift plan in legislation for a supplemental retirement system for new Federal employees, your committee and the Congress should ascertain the estimated revenue loss to the Treasury and include such loss as a part of the cost of the plan in comparison with the existing civil service retirement system. This is relevant not only to any matching Government contribution, but to the total employee contribution, both matched and unmatched, as well.

We are certainly in sympathy with the use of public and private pension funds for private sector capital accumulation purposes in light of a national savings rate far below that of some of our foremost international economic competitors. If provision for voluntary contributions to a savings plan is without Government matching, which is not ruled out in our set of proposed components, the revenue loss cost of such an arrangement should be offset by an appropriate modification of some other part of the pension system formula.

We recognize a definite and significant relationship between the thrift plan proposed in S. 1527 and the option offered to employees under the present retirement system to transfer into the new system.

Employees not approaching retirement age need to be brought under the new system. We concur in that strongly. Our committee has suggested that in order to avoid too wide a chasm between employees in the old and new systems and to lower future costs, those employees under age 45, as of the effective date of enactment, should mandatorily be brought into the new system with eventual benefits prorated between the old and new formulas based on the years of service under the respective systems. For example, assuming factor multipliers and retirement ages suggested above and assuming initial entry into Federal service at age 25, an employee at age 44 with 19 years of service coming into the new system would reach a replacement ratio of 45.25 percent at age 55, plus Social Security, both fully collectible at age 65. A 35-year-old employee would reach a replacement ratio of 36.25 percent at age 55, 10 years under the old system for 16.25 percent and 20 years under the new system for 20 percent.

In addition to the foregoing comments and recommendations regarding the four major cost aspects of S. 1527 which we believe need substantial tightening, we would like to submit a few additional items of Federal pension system policy which we would urge your committee and the Congress to consider when enacting a supplemental pension system for new hires.

The method and level of funding. The overriding need here is for full cost disclosure in such terms as to minimize the continuing argument about the meaning and accuracy of figures. To this end, we propose that:

First, each agency include in its budget the annual estimated actuarial cost as a percentage of payroll, exclusive of any employee contributions that might be mandated for the supplemental system;

Second, the consolidated balance sheet of the U.S. Government be required to reflect the accrued liability for both the new and the old systems, with annual increases in such accrued pension liabilities to be included as costs in the President's unified budget;

Third, full funding of the entry-age normal cost through agency inclusion in annual budgets pursuant to (first) above;

Fourth, a separate trust fund be established for the new plan. This would facilitate the need for full disclosure and the monitoring of the fiduciary responsibility of the trustees. In general, it will enhance fiscal discipline.

Various methods for handling the amortization of unfunded liabilities comprise difficult and controversial problems and require further study.

To repeat, all projected pension costs should be faced both initially and continuously thereafter.

To date, most of the analysis of Federal pension proposals done by the Congressional Research Service has been based on measuring entry-level normal cost and wage replacement ratios. While these are important evaluation criteria, they do not tell the entire accounting story. It is still necessary to provide financial projections of the trust fund assets, liabilities, receipts and disbursements on an accrual basis in order to assess the financial impact of the various proposals. While entry-level normal cost provides the best long-term indicator of adequacy in pension costing, we need an intermediate projection, 5 to 10 years, for the Stevens-Roth bill and the other plans which would show the following:

One, additions to the fund;

Two, deductions from the fund;

Three, net assets available for benefits;

Four, actuarial present value of accumulated plan benefits;

And five, unfunded liability.

An accounting model for preparing projections of the trust fund under the various proposals should be based on GAO supporting instructions to Public Law 95-595.

Recovery of the kicker. Retirees who benefited from the compounding effects of the 1-percent kicker which was in effect from 1969 to 1976, and costing an estimated $30 to $40 billion over the life expectancy of the retirees and their survivors, should receive no cost-of-living allowances until the Consumer Price Index rise is such that past costs attributed to the kicker have been recovered.

In addition to overcompensating retirees, the kicker substantially and unfairly widened the gap between retirees and active duty employees. To the extent feasible, the prekicker relationship should be restored.

Survivorship and disability. Survivorship coverage for spouses should be automatic rather than elective; criteria for disability benefit eligibility should be the same as those for Social Security disability insurance.

Senator **Stevens**. Something just came up. I am going to have to leave for a minute, Mr. Macy, when Senator Eagleton comes.

Let me ask you a question about the kicker. The kicker came into effect only after 3 percent, is my memory. When the CPI was 3 percent or more, the retirees got an extra kicker of 1 percent, so it went up to 4 percent.

But there was no adjustment to the No. 3. So during the period of time that was in effect, weren't we actually saving money because COLA's were not granted when the CPI was less than 3 percent? The 1-percent kicker was really an assurance of a means of compensating for not having had any adjustment during the period when the CPI was less than 3 percent.

Mr. **Macy**. I think the legislative record will show that the 1 percent was added onto the 3 percent, which was in the original statute in 1962.

Senator **Stevens**. But that was——

Mr. **Macy**. In order to compensate for intervening increases in the cost of living during the 6 months waiting period from the point of the 3-percent increase and its application.

When it was repealed, it was repealed for the future.

But those who had received it during this 7-year period continue to have that as a part of the compounding in the cost-of-living adjustments that they receive.

Senator **Stevens**. But during the period when the kicker was in effect, there was no cost-of-living adjustment for under 3 percent.

Mr. **Macy**. Mr. Keith is really the expert on the kicker. He is known as our "kicker back," and he can give you the chapter and verse on this.

Mr. **Keith**. I thought I had retired to Cape Cod for a life of luxury and living graciously. My pension began to go up, and at first I really looked forward to each of these increases with a great deal of pleasure.

It went up $150 a month on one occasion because it was applied not only to 3 percent, the 4 percent, but during the month or two that intervened before it was effective, it became 5 to 6 percent and on occasion it happened twice a year, 5 or 6 or 7 percent.

Senator STEVENS. My point is, if we followed your suggestion and found a way to credit for the kicker, shouldn't we go back and find a way to credit for those people who didn't get any cost-of-living adjustment for a substantial period of time?

Mr. KEITH. Everybody that was in the retirement system benefited from this.

Senator STEVENS. I understand that. For a substantial period of time there was no cost-of-living adjustment at all, and the kicker came into effect to compensate for that lag.

Mr. KEITH. For the time lag, that is right. But when they were coming every 5 or 6 months, and one's pension was perhaps $1,500 to $2,000 dollars a month, as mine was, it gave every Federal retiree more than was necessary, and it was applied to the little fellow as well as the big fellow.

Senator STEVENS. I am sorry. I have to go to another meeting, gentlemen. Thank you.

Mr. MACY. Thank you, Senator.

Senator Eagleton, may I continue?

Senator EAGLETON [presiding]. Yes, yes, you may, Mr. Macy. I am delighted that you are here as a witness. You have had a long and distinguished career in Government. I am delighted to be here while you are testifying.

Mr. MACY. Thank you. I am here with respect to this particular legislation because of my long time involvment in the development of public policy with the Congress. In my position of Chairman of the Civil Service Commission, some of the programs that were initiated in the name of the improved retirement conditions during my regime require some corrective action to adequately reflect current conditions.

In the process of dealing with page 9, the topic of survivorship and disability, I will repeat that in order to give you the full context.

Survivorship coverage for spouses should be automatic rather than elective; criteria for disability benefit eligibility should be the same as those for Social Security disability insurance; and a percentage cap, at a level determined by Congress, should be placed on total disability payments to an individual from private pension plans, Social Security and other employer- or Government-sponsored plans, the cap being set at a percentage of final annual pay prior to disability.

Double counting of military service. In legislating the supplemental pension system, the Congress should prohibit the continuation of the practice whereby time spent in military service is counted twice in determining the benefits of the Federal workers who participated in both programs. In view of the administrative problem in implementing this prohibition, the Department of Defense and the Office of Personnel Management should be mandated to develop the necessary processes to avoid the duplication of retirement credit.

Mr. Chairman, in conclusion, we wish to emphasize the urgency of the problem with which this committee is dealing. We believe the plan that we have proposed, the 12-point plan, after extended study, provides the most equitable and affordable approach to a new supplemental plan in which Social Security is a fundamental and universal base. The PEPS supplemental plan—PEPS is the acronym for our committee—offers a pension which is more nearly comparable to those of the private sector. These changes are essential to sound public policy for the future to assure an adequate retirement level for the civil servant and to lessen the burden on the American taxpayer.

What started out as a good system in 1920 got out of hand in the 1960's and 1970's. We radically improved the pay of the rank and file civil servant and almost simultaneously introduced indexing. The end result is that our gross liabilities are increasing at a rate of about $50 billion per year.

Because of these inequities, it has become increasingly clear that we are threatened by imports from countries which do not have such extraordinarily generous pension systems. We are fast approaching the point of which Adam Smith wrote in the 18th century when he stated:

> When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue . . . has always been brought about by bankruptcy; sometimes by an avowed one, but frequently . . . by a pretended payment.

Many members of our committee played a key role in the shaping of the Nation's retirement policy. We know at first hand through our own exposure of the extraordinary inequities. We believe substantial changes such as we have proposed before this and earlier Congresses must be made in the civil service retirement system, both currently and prospectively. Only if we take these steps can we avert the crisis that we helped to create.

I thank you, Mr. Chairman, and I thank the other members of the committee who hopefully will read this record. This concludes our written statement. We have attached to our statement documents which we believe may be useful to the members in considering the proposals.

I want to, again, introduce my associate and cochairman, Hastings Keith, a Member of the Congress for many years, and also we have with us Mr. William O'Reilly, who is the treasurer of our committee and a very experienced man in the accounting area. His contribution to the section with respect to the accounting and Treasury record has been very significant.

The three of us are here to respond in any way that would be useful, either at this hearing or at some later time with individual members or with the staff of the committee.

Thank you very much, Senator Eagleton.

Senator EAGLETON. Thank you, Mr. Macy, and thank you, Mr. Keith. I do have some questions. You will have to bear with me a bit. I was not here at the outset of your testimony. I am going to try to recapitulate, at least for my own purposes, your point of view. I would like you to do it item by item on some of the more contentious items in these proposals.

For instance, with respect to COLA, the Social Security COLA would remain at its present 100 percent. What would be the COLA with respect to anything else?

Mr. **Macy**. That would be the COLA.

Senator **Eagleton**. That would be the only COLA.

Mr. **Macy**. There would be no COLA beyond that.

Senator **Eagleton**. No COLA beyond that. OK, zero COLA beyond Social Security.

Mr. **Macy**. Unless the total income was less than $10,000, the maximum for Social Security.

Senator **Eagleton**. OK.

Mr. **Keith**. Could I elaborate on that?

Senator **Eagleton**. Sure.

Mr. **Macy**. Please do.

Mr. **Keith**. I brought a little chart, exhibit A, that shows the benefits for the country as a whole and how it affects me as a lucky fellow to have $72,000 of indexed pensions, $10,000 of which is Social Security. We would protect that $10,000 Social Security fully. If I wasn't getting the Social Security pension, would any other pensions be indexed so that I would draw $10,000—indexed—but no more than $10,000.

Here we have the total liabilities. These are the total liabilities in billions for the present retirees on the assumption that they get no increases in pensions. That is on a static assumption.

If there is a 5-percent increase because of inflation, those total liabilities go up to $778 billion for the present retirees.

If there is a 10-percent rate of inflation, those liabilities would go up to $1,411 billion.

If S.1527 was in effect and we were to have 5-percent inflation—then 60 percent of the total would be paid to these retirees, under CPI minus 2; $610 billion during the course of their lifetimes. In the event of 10-percent inflation; the amount would be $1,200 billion.

How does it work out for an individual? Charles Morris, one of our committee members, retired in 1965 with a pension of $395 a month. He had been 42 years with the Treasury Department. He and I are featured in exhibit B.

[The information referred to follows:]

EXHIBIT A

Pension Liabilities of Present CSRS Retirees Under 0%, 5%, and 10% Inflation Rates

(1,388,616 retirees, Average pension = $13,000, Average age = 68, 54% survived by spouse for 9 years)

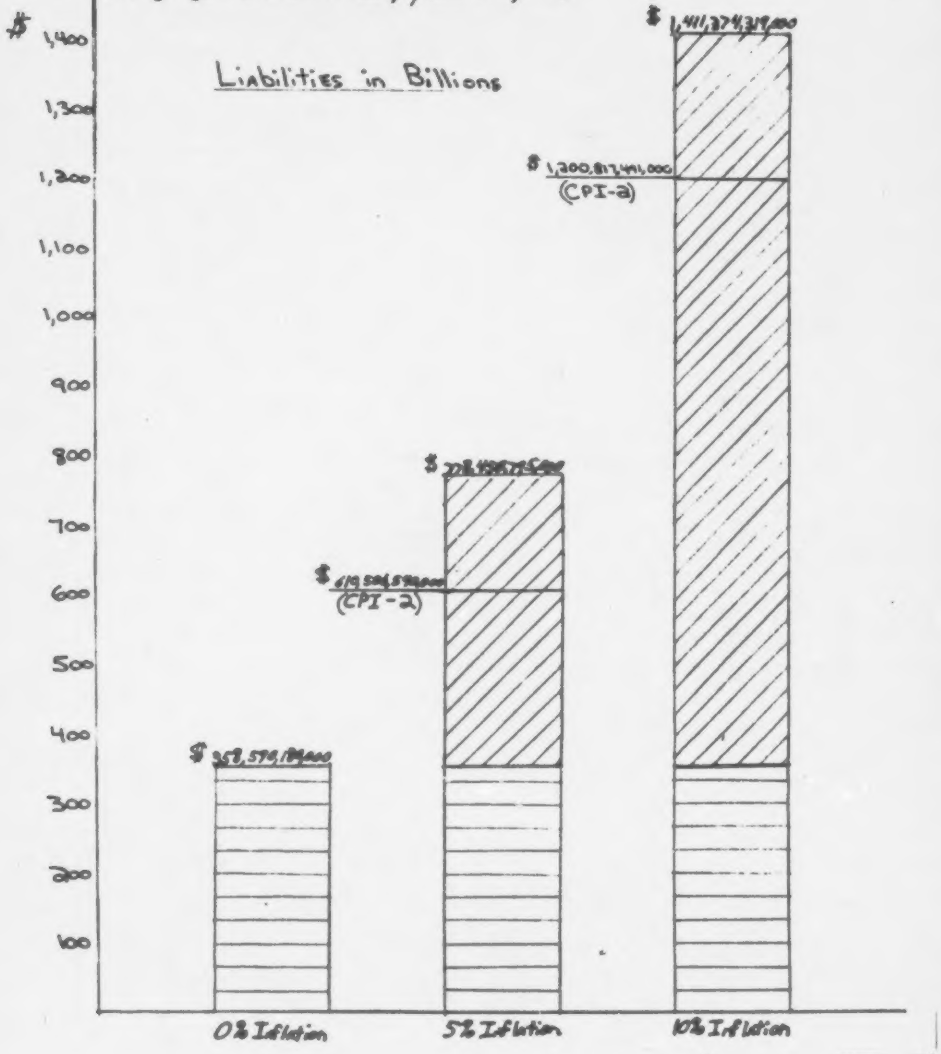
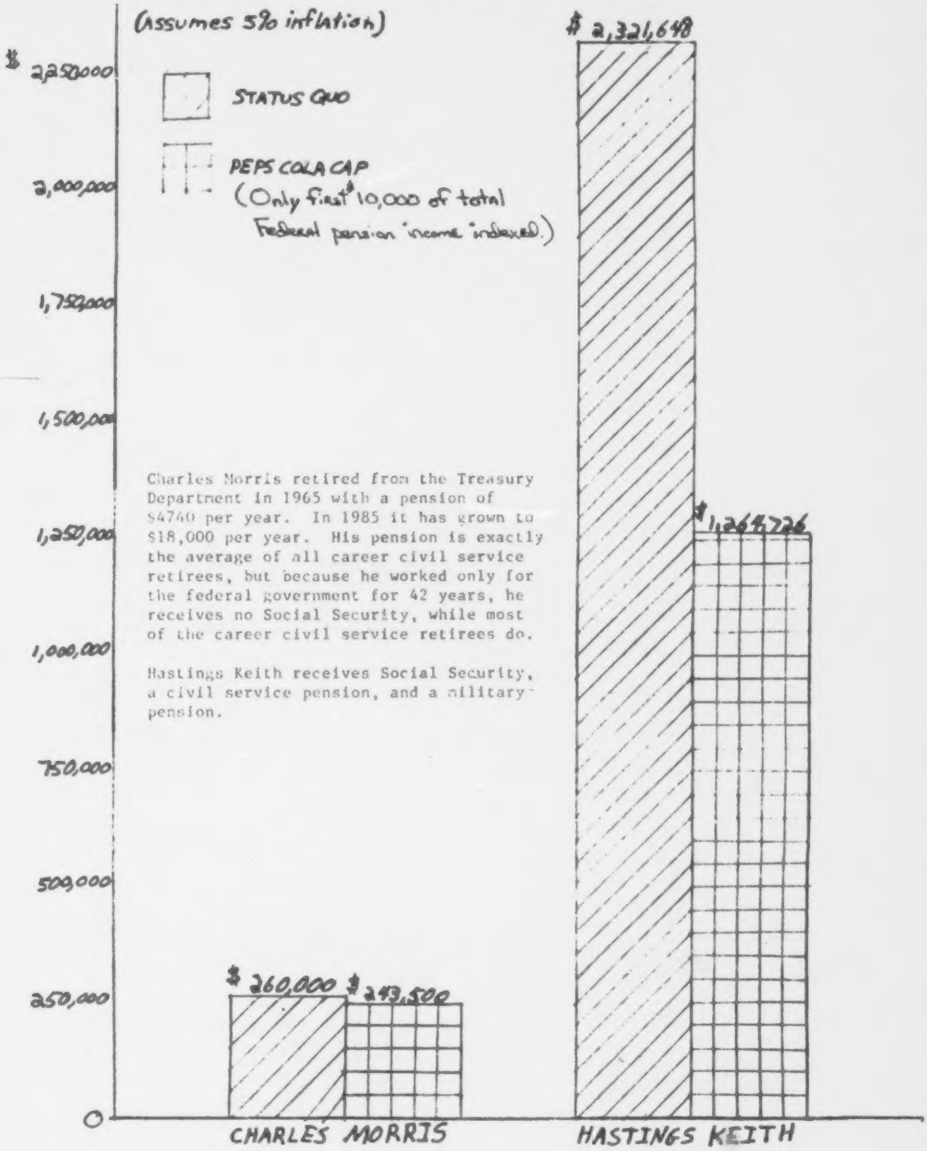


EXHIBIT B

Future Pension Benefits of Two PEPS Members
Under the Status Quo and the PEPS COLA Cap



Charles Morris retired from the Treasury Department in 1965 with a pension of $4740 per year. In 1985 it has grown to $18,000 per year. His pension is exactly the average of all career civil service retirees, but because he worked only for the federal government for 42 years, he receives no Social Security, while most of the career civil service retirees do.

Hastings Keith receives Social Security, a civil service pension, and a military pension.

Mr. KEITH. His pension is now $18,000 a year, which happens to be exactly the average Federal pension for a career employee, that is, $1,500 a month, $18,000 a year.

Under the proposal which we advocate, just indexing the first $10,000, Morris would have practically no cuts in future benefits. At a 5-percent rate of inflation, he would get $243,500 instead of $260,000 in the future years. These benefits are for him and his wife survivor. That is the amount of money they would get at a 5-percent rate of inflation.

Under the status quo, I would get $2,321,648 at a 5-percent rate of inflation over the next 12 years of my life and 10 years of a surviving spouse. If you put into effect the cap of $10,000, we would get $1,264,000, that is, I and/or my widow would get that amount of money.

Now, it is our contention that the cost-of-living portion of the pension is what should be indexed, and indexing only the $10,000 will take care of the average food and clothing and reasonable transportation and reasonable living expenses, rent.

The average Social Security recipient gets $474 a month. So this would take care of the safety net for everybody. If the Congress adopts the CPI minus 2, that means the fellow getting $474 a month would not get the whole pension. He would get CPI minus 2. If it was 5 percent, he would get 3 percent, and 3 percent of $474 is about $14 a month.

In my case, I got, I think, about $2,400 on January 1 of this year for the next year. I got $200 a month, if I recall correctly. If you leave it as is now projected, I am going to get another $180 a month—3 percent on $72,000 next year. Starting on January 1, I get another $180 a month. I don't need it. Charles Morris needs it on his $10,000; and the fellow back in Brockton, his earnings record is poor because the shoe business fell apart, needs it. So, too, does the guy in New Bedford who was working in a textile mill.

The fellow who has been working for those industries is going to be without a job if this trend continues. We feel that in the long run, these kinds of unfunded liabilities paid off with borrowed money will have a very serious effect and continue to have an increasingly serious effect.

This little recording machine I have here, which I just bought for this purpose, was made in Korea and assembled in Mexico, and the batteries came from Singapore. The only thing that was made in America was the notice attached thereto telling where it was made and how to operate it.

We can be, if we are not careful, in the position of England in recent years when it became a nation of shopkeepers until they discovered oil. We could become a nation of service companies. We need to protect those basic industries by staying competitive. Hong Kong has no Social Security system. We are now seventh in the world in giving pensions to our workers. We need to cut it down, and we need to have the Federal Government play a lead role in doing its bit.

Thank you.

Senator EAGLETON. Mr. Keith, now we have discussed the recommendations on COLA. On retirement age, you would have the retirement age at 65?

Mr. MACY. Sixty-five, the same as Social Security.

Senator EAGLETON. The same as Social Security.

Would you have any special provisions for law enforcement, air traffic controllers and the like?

Mr. MACY. We have not addressed the special groups in here. We have not studied them. My own personal view is that in the hazardous careers, the compensation for the actual service should be such as to cover their costs. I would much prefer to see pressure placed upon the employing agencies to retrain those who move out of those jobs and give them other opportunities rather than have them retire early.

Senator EAGLETON. Did you discuss the thrift plan?

Mr. MACY. Yes. We discussed that at some length, starting on page 5.

Senator EAGLETON. Could you give me a capsule of that? The Stevens bill calls for a dollar-for-dollar for 5.

Mr. MACY. Mr. O'Reilly.

Mr. O'REILLY. Senator, the concern that we have on the thrift plan is that, first of all, the design of the PEPS pension program, we feel is adequate, without a thrift plan, but I would like to address the cost aspect of the thrift plan. I have participated and listened to the testimony for the last 2½ days, and, in fact, there has been very little attention focused on the subject of what is the impact in terms of lost revenue to the Treasury and the cost of the thrift plan.

Every decision, every design choice that is made in the pension program has a cost impact. One of the disappointments has been that a question has not been asked which is: What would that cost? I would like to have heard that, because a lot of our analysis deals with dollars.

Senator EAGLETON. I don't know if you were present on Monday when I had questioned Mr. Biller and took him through, item by item, the cost as a percent of payroll on all of the so-called most controversial issues. I took him through COLA, retirement age, thrift, level contributions, accrual rate, et cetera.

Mr. O'REILLY. It is true that there has been quite a bit of discussion on the ratio of percentage elements of normal cost.

For example, on indexing, we know that the civil service retirement system is 11.5 percent, whereas the private sector is 4.6. You do get a pretty good comparison by looking at these percentages of normal cost.

On the thrift plan, I haven't heard anyone discuss the fact that we will be sheltering tax income of $100 billion in the next 15 years. Where does the $100 billion come from? We tried to take the best estimates from the curve of the new employees coming into the system. There are 300,000 in now since January 1984. I believe on Monday, the Comptroller General testified that in 10 years, most of these people will be in the new system. I have used a less conservative rate. In fact, I only had 60 percent coming in in the next 15 years.

Still, if you take the payroll provided by OPM and their projections out to the year 2000, multiply that and compute the payroll of this new group, multiplied by a factor of 3 percent, assuming the assumptions of the Congressional Research Service or as Senator

Stevens has said, and I would agree that more than 60 percent of the employees will avail themselves of the thrift plan option.

If you operate on the maximum participation of all people participating and take 5 percent of the payroll as the Government match, that is $32 billion. You double that, and you have $64 billion of sheltered income of the employees' income before taxation.

That is $100 billion times the assumption of 30 percent of the tax bracket that they are in, and we have lost revenue to the Treasury of $30 billion. As Mr. Macy said, let's consider that as part of the costs of this program, a typical before and after analysis.

Mr. MACY. In other words——

Senator EAGLETON. What about the investment if those funds remained in-house? What about the investment increases in revenue due to the employees investing their CAP contributions in Government securities?

Mr. O'REILLY. In Government securities?

Senator EAGLETON. Yes.

Mr. O'REILLY. I think the fundamental point that should be recognized is that Government securities are not real assets when you look at the stewardship function of a trustee, of a fund.

We know that those Treasury securities are offset by IOU's to the Treasury Department. On the Government accounting basis, we have an offset, even when we get to the unified budget. The assets in the civil service retirement trust fund are not included in the debt to the public. It is just a bookkeeping transaction.

What it really means is that now we are looking at, as of 1984, $537 billion of debt. That is the present value of the accumulated plan benefits.

It is true that there is $126 billion of assets, but they really are not assets in the sense that the private sector would hold debt instruments. These are instruments that can only be liquidated through additional taxation or additional borrowing.

So even if it is fully funded, we are not really too concerned. We think there are advantages to fully funding the trust fund, but we should not lose sight of the fact that financing it only with debt securities is just putting the problem off to the next generation.

Somebody ultimately has to borrow the money or pay the taxes to liquidate those debt securities.

I think that you are insulated from this point if the investment is made in the private sector. Our committee has not taken a position on that.

Senator EAGLETON. You have not taken a position on the inside/outside investment question?

Mr. O'REILLY. Correct.

Senator EAGLETON. What about the accrual rate? The Stevens bill is 1.0. Do you recommend the COLA, the 0.5?

Mr. MACY. After 30 years, the 0.5.

Senator EAGLETON. Did you address this question of what is called level contributions by employees? That is, under the old plan, the employee puts 7 percent into the retirement system and 1.3 percent into Medicare, for a total of 8.3. Under the Stevens bill, he puts in just 7 percent.

So in terms of what comes out of his or her pocket under the Stevens bill, under the new plan, the employee gets a better deal. I am talking about just what comes out of pocket.

Question: Should we increase what comes out of the employee's pocket another 1.3 percent to make it level, new employees level with old employees?

Do you have any comment on that?

Mr. O'REILLY. No, Senator, the only thing paid by the employee would be the Social Security contribution.

Senator EAGLETON. I am a little hard of hearing.

Mr. O'REILLY. Only the Social Security, the FICA contribution, would be paid. The entire second tier would be paid by the employer.

Senator EAGLETON. That is true under the Stevens bill.

Mr. O'REILLY. Yes.

Senator EAGLETON. But the proposal is, in order to make new employees in this regard level with old employees, that we take another 1.3 percent out of their paycheck and put it in either the defined benefit pot or the CAP pot.

Mr. O'REILLY. Senator, I think the recommendation that our committee has made is more practical, and that is to bring all of the employees under 45 into the new system so they are treated the same way; cut off the benefits earned right now; and then calculate their new benefits on the same basis as you are the 300,000 new employees.

Mr. MACY. Yes. That is really one of our major proposals. Our view is that it is going to take an excessive period of time with a dual system, unless we can make an earlier rate to include a higher number under the Social Security plan.

The number of years, Senator, is arbitrary, but we felt that that was far enough away from an expected retirement date that it would be a logical point for making the change.

Senator EAGLETON. As a percent of payroll, the present system costs about 25 percent. The Stevens bill, as a percent of payroll, is about 20.8 percent. The average in the private sector is about 19.3 percent.

What is your guess as to what your plan prices out at as a percent of payroll?

Mr. O'REILLY. Senator, the proposed plan has a cost of 14.5 percent, but I would like to amplify on what you said. If you look at the normal cost of that group that we are concerned with, namely—those who get early retirement, which is the major cost the person with 30 years of service at age 55—what is normal cost for that individual or that class of individuals?

Now, we have a study prepared for OPM done by Towers, Perrin, Forster & Crosby which broke that out. I think it casts a lot of focus on a very important point: That the normal cost for that particular group is 46.5 percent.

Senator EAGLETON. That is, people with 30 years who retire at 55.

Mr. O'REILLY. Yes.

Senator EAGLETON. But the average age of Federal retirement, if I recall it, is 61 or thereabouts.

Mr. O'REILLY. The normal cost rate?

Senator **Eagleton**. No, the average age of retirement for Federal employees is 61 or thereabouts. Thus, when you crank out only the 55, the 30 years of service folks, important as that is costwise, et cetera, nonetheless, it is an atypical group of the overall Federal work force insofar as retirement is concerned.

Mr. **O'Reilly**. It does indicate the fact that the cost of offering that is much higher.

Senator **Eagleton**. It is costly. I am not saying it is cheap; no, sir. I don't want to be misinterpreted. It is a costly factor. The single most costly factor, as our figures show, is COLA.

Mr. **Macy**. That is right.

Senator **Eagleton**. And your chart, Mr. Keith, shows that very dramatically. COLA is the biggest driving force in the upward escalation of costs in the retirement system, and in Social Security, and any other thing that is geared to it.

Mr. **Keith**. Senator, the average age of 61 or 62 is driven up by the fact that a great many people have a lot of earlier service in the private sector or earlier military service that is counted, so that the average number of years serving in the civil service system is far less than 30, because that figure includes people who entered at the age of 60 and retired at the age of 65 or 72. I think the average entry age is probably somewhere close to 30 or 35.

Senator **Eagleton**. I can't either agree with you or dispute it. I have so much trouble keeping figures in my head, I don't know that figure.

Mr. **Keith**. I think you do very well, but I remember back in 1975 a lead editorial in a Washington newspaper about your making reference to the "the pension time bomb." It was a speech in New York that you made. I have a copy of it.

Senator **Eagleton**. Oh, my God. You are the only living American that remembers that. [Laughter.]

There was an obscure little fellow in Hong Kong who also remembered. [Laughter.]

You are the only two on the globe. [Laughter.]

Mr. **Keith**. Oh, no.

Mr. **Macy**. No, we have it pasted on the wall. [Laughter.]

Senator **Eagleton**. Well, I meant it then, and I mean it now. The pension time bomb is there. It is ticking. You look at the outyear figures nationwide, both public and private, and they frighten you to death. I put some articles in the record on Monday on the anticipated increase in health care costs. When you factor that into Medicare expenses in the future and private health care costs and into insurance costs that employees have in the private sector and et cetera, et cetera, that frightens you to death. There is a double whammy. It is incredible.

Mr. **Macy**. That is why, Senator, there is such an urgency and such an importance in what is being considered here. Because here is an opportunity to at least partially defuse a bomb without injuring the people that are covered, and to put this on a more equitable and affordable track for the future. That is really what we have endeavored to do in these 12 points.

Admittedly, this is a much more restrictive program than the bill or other proposals that have been advanced, but we feel an obligation to offer that as an option.

Senator EAGLETON. So you, Mr. O'Reilly, you say payroll cost is about 14.5, you think, on this package?

Mr. O'REILLY. The study by OPM pricing out our proposal reported that the normal cost was 14.5 percent of payroll.

Mr. KEITH. I would like to comment, if I could, on the average private sector plan. I think that the average Fortune 500 plan takes about 9 percent of payroll plus Social Security contribution.

Senator EAGLETON. Really? That doesn't track with our figures.

Mr. KEITH. It was given to me yesterday by the Wyatt Co.; I made one other call.

Senator EAGLETON. We have got 19.3, corporate average, but that is big, medium, and little companies in our average.

Mr. KEITH. I can get these figures for you.

Senator EAGLETON. Yes.

Mr. KEITH. They are terribly important. Certainly, there is no shoe company in the country that can afford to pay 9 percent of payroll. When the President's Commission on Pension Policy recommended what they call MUPS [mandatory universal pension systems], 3 percent of payroll for all the employees for all the employers in the country would have been mandatory. That would have ruined practically every New England shoe factory or Mom and Pop store, to add 3 percent to the cost of doing business. We are selling our goods in a world market. To add 3 percent more to the cost of doing business in America would have been an impossible burden for our society.

Senator EAGLETON. We had a witness yesterday who said some day Congress would mandate 100 percent COLA for every corporation in America. I slightly disagree.

Mr. KEITH. I was present at a hearing within the last week. It was on the House side, the Committee on Social Security. If there is one thing that frightens the private sector, it is the possibility of indexing above the Social Security amount.

We wouldn't have an industry that would survive. The cost of putting this plan into effect that we now have for the civil servant would add—I can't give you the figure off the top of my head, but it would put us right out of world markets if they had to add this kind of cost to the payrolls of the existing private sector work force.

Senator EAGLETON. Thank you, gentlemen, very much. I would like to read a short statement into the record.

Questions have been raised concerning my reference here yesterday to the GAO's testimony that if employees contributed 1.3 percent to the thrift plan, they could generate about 12 percent of salary in terms of benefits at the time of retirement. I compared this to the fact that having employees contribute 1.3 percent to the defined benefit plan would generate an increase in benefits equal to only about 3 percent of their salary.

I will place into the hearing record a more detailed analysis of this comparison, along with some additional comparisons under various alternative sets of assumptions. I trust this will help to clarify the point that I was trying to make yesterday.

[The information referred to follows:]

A COMPARATIVE ANALYSIS OF CONTRIBUTIONS TO DEFINED BENEFIT PLAN vs. CAP PLAN

The following information is presented for the purpose of comparing the marginal increase in retirement benefits that would be generated by contributing either an additional 1.3 percent of pay to the defined benefit plan, under S. 1527, or contributing a like amount to the S. 1527 capital accumulation plan (CAP).

Based on cost data developed by the Congressional Research Service (CRS), contributing an additional 1.3 percent of pay to the defined benefit plan would allow the pension accrual factor to be increased from 1.0 percent of "high-5 average salary" for each year of service to about 1.1 percent of "high-5" for each year. This 10 percent marginal increase in the accrual factor would produce, over a 30 year period, a retirement benefit equal to 3.0 percent (0.1 x 30) of "high-5" salary. Three percent of "high-5 salary" is equivalent to approximately 2.7 percent of final salary. However, since S. 1527 provides for a 2.0 percent a year reduction in benefits for each year under age 62 at time of retirement, retiring at age 55 would reduce the 2.7 percent benefit by 14 percent (2.0% x 7 years), resulting in a final benefit of about 2.3 percent of final salary.

The amount of an annual annuity that could be provided by contributing, over a 30 year period, to the S. 1527 CAP plan depends on various assumptions. The assumptions relate to the salary history during the period, the rate of contributions, the average annual rate of return on investments, the inflation rate, and the age of the individual at time of retirement.

For purposes of this comparison, the assumed salary history was based on the actual annual increases in the social security National Average Earnings over the past 30 years. The average annual rate of increase in salary over the period was about 5.5 percent.

Two alternative annual contribution rates were assumed -- a rate of 1.3 percent of salary and a rate of 1.5 percent of salary. The 1.3 percent rate represents the current, after-tax contribution that would be required to maintain parity in employee contributions between the existing civil service retirement system and the retirement program proposed by S. 1527. The 1.5 percent rate is the before tax equivalent of the 1.3 percent rate, assuming a marginal tax rate of approximately 13.3 percent.

Also, two alternative sets of interest and inflation rates were assumed. One set includes an interest rate (i.e., average annual rate of return on investments) of 6.1 percent and an average annual inflation rate of 4.0 percent. These are the same rates as CRS assumed in computing cost data for S. 1527.

The second set represents the General Accounting Office's (GAO) assumptions and includes a 7.5 percent interest rate and a 5.4 percent inflation rate. According to a GAO official, they assumed a 7.5 percent interest rate because it is, currently, the statutorily guaranteed rate of return on U.S. Government savings bonds.

The following table shows, as a percentage of final salary, the amount of an annual annuity that could be provided to male at age 55 and at age 62, after participating in the CAP plan for 30 years. The assumed contribution rates include a 100 percent government matching contribution, as provided for in S. 1527 thrift plan.

Contribution Rate: 2.6%
Interest Rate: 6.1%
Inflation Rate: 4.0%

Age	Full COLA	50% COLA	No COLA
55	4.2	5.3	6.6
62	5.3	6.4	7.7

Contribution Rate: 3.0%
Interest Rate: 6.1%
Inflation Rate: 4.0%

Age	Full COLA	50% COLA	No COLA
55	4.9	6.2	7.6
62	6.1	7.4	8.9

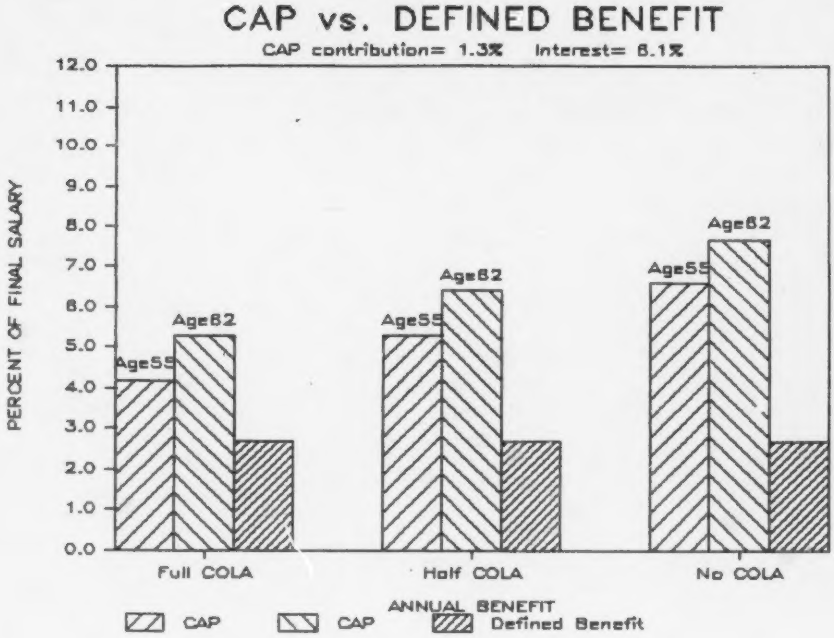
Contribution Rate: 2.6%
Interest Rate: 7.5%
Inflation Rate: 5.4%

Age	Full COLA	50% COLA	No COLA
55	5.2	7.1	9.3
62	6.5	8.4	10.6

Contribution Rate: 3.0%
Interest Rate: 7.5%
Inflation Rate: 5.4%

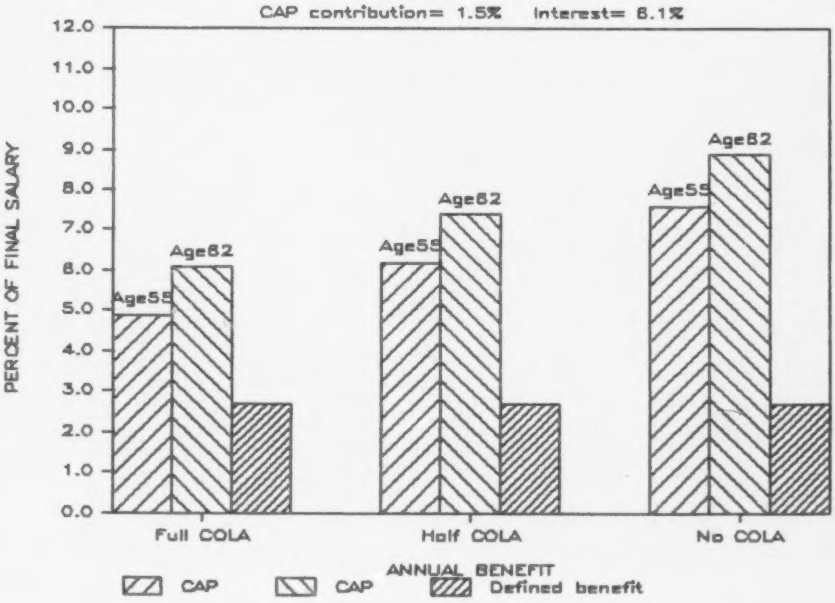
Age	Full COLA	50% COLA	No COLA
55	6.0	8.2	10.7
62	7.5	9.7	12.2

It can been seen that, given the provisions of S. 1527 and based on the assumptions used, a given contribution to the CAP plan will, in all cases, produce a greater marginal benefit than that generated by contributing a like amount to the defined benefit plan. This result is primarily, if not entirely, due to the 100 percent employer matching contribution provided for under the thrift plan.

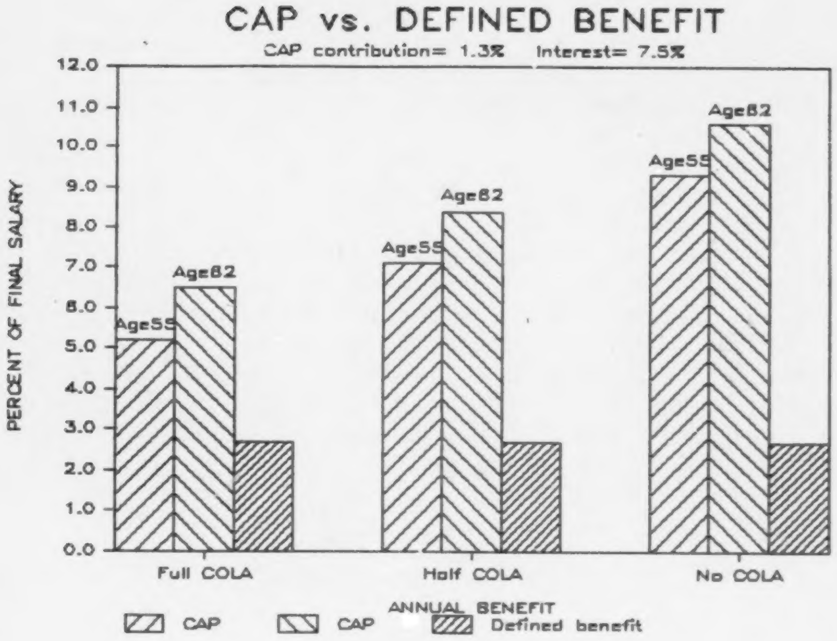


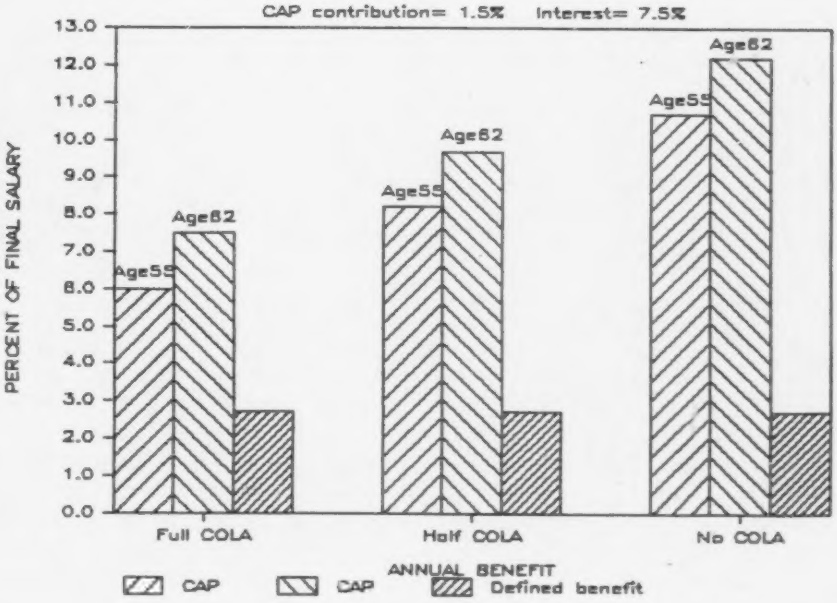
CAP vs. DEFINED BENEFIT

CAP contribution= 1.3% Interest= 6.1%



CAP contribution= 1.5% Interest= 6.1%


CAP vs. DEFINED BENEFIT
CAP contribution= 1.3% Interest= 7.5%
PERCENT OF FINAL SALARY
12.0
11.0
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Age55
Age62
Full COLA
Half COLA
No COLA
ANNUAL BENEFIT
CAP
CAP
Defined benefit


CAP contribution= 1.5% Interest= 7.5%
PERCENT OF FINAL SALARY
13.0
12.0
11.0
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Age55
Age62
Full COLA
Half COLA
No COLA
ANNUAL BENEFIT
CAP
CAP
Defined benefit

Mr. KEITH. The TVA system has early retirement, and it is levied against or paid for by reducing the costs to the employer of the early retirement that they give to the man retiring at age 55. They fund an additional amount for him until he reaches 65 and the Social Security kicks in.

Then their contribution to his retirement income is lowered. It enables them to give a much more generous early retirement benefit by having that offset against Social Security, and the private sector does that. All the giant industries, steel, autos, and oil all provide offsets, and for their early retirees, they take it from the till, and then they diminish the amount of income that they have to give when the Social Security kicks in.

Senator EAGLETON. But there is also a new trend in industry: Sweeteners to induce early retirement. Did you read the article on CBS this week? I think CBS is offering some extremely attractive packages to induce early retirement.

[The article referred to follows:]

[From the New York Times, Sept. 9, 1985]

CBS CUTS MORE THAN CORNERS

(By Caroline Rand Herron and Michael Wright)

CBS Inc., disclosed last week how it would try to offset part of the high price it had to pay in turning back Ted Turner's takeover offensive this summer: about 2,000 people, 7 percent of the company's workforce, will be given incentives to retire early. Under the plan, all employees who are at least 55 years old and have 10 years' pension credit will qualify for "significantly increased" pension benefits, CBS said. The company's normal retirement ages is 62. An industry expert estimated that the plan might save $7 million a year. The company has an annual cost-saving target of $20 million.

CBS warned in July, when it bought 21 percent of its own shares to block the takeover effort by Mr. Turner, the Atlanta broadcast entrepreneur, that it would have to cut corners and some offices. The expensive arrangement was paid for in cash and new securities, which carried a condition barring the type of offer Mr. Turner had made. The deal pushed CBS's debt to $1.3 billion, more than three times its level at the end of 1984. A soft advertising market and disappointing demand for television in time in the third quarter have hurt not only the network but the television industry.

The retirement plan is CBS's biggest cost-saving effort so far. The broadcast division has been ordered to keep budget increases to 4 percent in 1986. Within the division, CBS News wants to trim $6 million. "Corporate executives are being very tough this year," said a divisional executive who asked not to be named. But, he added, it is not always hard to find places to cut back because "bureaucracies grow at night."

Mr. KEITH. Du Pont did it just recently, and they had a lot of people take it up. And the early retirement package that they offered was at age 55, and it didn't provide as generous a benefit as we automatically give at age 55.

Senator EAGLETON. I am not saying dollar-for-dollar, but I hastily read the article. I can find it and put it in the record, but it was on CBS, and the headline described it as extremely attractive offers by the corporation to induce early retirement. As you say, Du Pont has done it. I don't have in my head the dollar-for-dollar comparison.

I thank you gentlemen for your participation.

[The joint statement of Messrs. Macy and Keith follows:]

National Committee On
PUBLIC EMPLOYEE PENSION SYSTEMS (PEPS)
1221 Connecticut Avenue, N.W. Washington, DC 20036 202/293-3960

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JOINT STATEMENT OF JOHN W. MACY, JR.

AND HASTINGS KEITH, CO-CHAIRMEN,

NATIONAL COMMITTEE ON PUBLIC EMPLOYEE PENSION SYSTEMS

BEFORE THE

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

SEPTEMBER 11, 1985

Mr. Chairman and Members of the Committee:

We appreciate very much your invitation to our Committee to present views regarding the characteristics of the new retirement system for federal employees entering service subsequent to December 31, 1983. For the record, our respective residences are 5047 Glenbrook Terrace, N. W., District of Columbia (Keith) and 1127 Langley Lane in McLean, Virginia (Macy). This statement is presented in our capacities as Co-Chairmen of the National Committee on Public Employee Pension Systems (PEPS).

The membership of the Committee appears on our letterhead; practically all the members are former elected officials or employees of the legislative and executive branches in national, state and local governments, and most are receiving pensions from one or more public retirement systems. PEPS is organized as a non-profit corporation and receives its financial support from contributions and grants from its members and private foundations and businesses. The Committee first came into being because of shared concerns about some of the equity and affordability aspects of public employee pension systems, especially the federal civil service and military retirement systems.

The Committee has conducted some original research, including a study of replacement ratios and the measurement of retirement income necessary to maintain pre-retirement consumption levels--"consumption maintenance" in contrast to "income maintenance". However, the bases for its considered views have relied extensively on data collected by others, including principally the research and evaluation arms of the Congress and the Federal Executive Branch (GAO, CRS, CBO, OMB, OPM, BLS and Census); previous study commissions, and private and non-profit organizations such as the Employee Benefit Research

Institute (EBRI), the Brookings Institution, and the National Bureau of Economic Research.

Drawing upon the foregoing resources, early this year the Committee adopted a list of essential components of a supplemental retirement plan for post-1983 hires within the context of a defined benefit structure; the list is appended. Coincidentally, its general thrust conforms rather closely to the conclusions of the Brookings research team which last year addressed overall issues associated with growing budget deficits. Regarding federal retirement systems, the findings, as reported by Dr. Alice M. Rivlin in the Brookings Review, Summer, 1984 were:

> Both the civil service and military retirement systems should be changed to bring them more in line with private-sector pension plans. For future retirees, initial benefits should be reduced somewhat and full benefits should be available only to those sixty-two years of age or older. Benefits for current and future retirees should be only partially indexed for inflation.

Our Committee compliments the sponsors of S.1527 for their initiative in introducing legislation that moves meaningfully toward redressing those aspects of federal pension systems targeted by the Brookings study--namely, increasing the age for unreduced benefits, reducing the level of future benefits, and partially, rather than fully, indexing for inflation. However, desirable as these steps are, they do not in our view go far enough to meet the critical problems of inequity and unaffordability that plague the present federal civil and military pension systems. We believe that S.1527 needs to be strengthened in several respects.

> The normal retirement age should be increased to coincide with that of the Social Security system--namely, 65 initially and higher in later decades.

The factor multiplier for years of service should be reduced from 1.0% to 0.5% for years of service beyond 30.

The actuarial reduction for early retirement should be increased to six percent annually for all voluntary retirements below age 62; and a reduction of three percent annually should be imposed for the period 62 to 65.

The COLA provision should be changed to index only that portion of total federal pension benefits (including Social Security) which is equal to the Social Security maximum benefit (with amounts beyond that un-indexed).

Present employees not "approaching retirement age" (e. g. age 45) should be brought into the new system, with benefits pro-rated according to length of service in old and new systems, respectively.

Future pension payments made to retirees and survivors should fully or partially exclude the one percent "kicker" which was in effect from 1969 to 1976 from the calculations base.

Double counting of military service for both civil service and military retirement purposes should be prohibited.

Finally, projected Treasury revenue losses arising from exclusion from gross income of employee and employer contributions to the proposed thrift plan should be calculated; and such loss should be included in computing costs of the new system in comparison to the present system.

The following paragraphs summarize our Committee's position regarding the major components of pension system cost in which we believe the provisions of S.1527 should be modified substantially.

Normal Retirement Age and Actuarial Reductions

We propose that the normal retirement age for the new system be 65 initially, with future increases as mandated by the Social Security Amendments of 1983, and with early retirement subject to a 3 percent reduction for each year age 62 to 65 and a 6 percent reduction for each year age 55 to 62. In contrast to current high rates, this represents a low rate of early retirement subsidization (full actuarial reduction at 55 would be 60%, in comparison to our proposed 51%--7x6% plus 3x3%).

We question the approach taken in S.1527, whereby the normal retirement age is pegged at 62 rather than 65 and whereby actuarial reductions are tied to whether or not the retiring employee has 30 years of service; this can create frequent "notch problems". More important, with continuing dramatic increases in life expectancy, it is fiscally unrealistic in our view to provide full benefits below the Social Security retirement age. We believe that the five percent reduction below age 62 specified in S.1527 for retiring employees with less than 30 years' service should be extended to all voluntary early retirements and be increased to six percent, with annual reductions of three percent for those retiring employees between ages 62 and 65.

Cost-of-Living Adjustments

We propose no COLA for the supplemental benefit for so long as the Social Security benefit is fully indexed. (For present retirees, we have for several years urged a capping of civil service and military COLAs at the level of maximum Social Security benefits--currently approaching $10,000). This approach is much more equitable and adequate for those on lower retirement incomes than by simply adopting a formula such as CPI minus two as provided in S.1527.

Thrift Savings Plan

As shown in the appended "Essential Components of a Supplemental Retirement Plan" for post-1983 federal hires, our Committee states under point XII: "The foregoing plan components provide adequate retirement income for the federal retiree. Consequently, the Committee believes a government-financed supplemental thrift/savings plan is not required."

The Committee recognizes that such plans are a growing part of the pension plans of larger corporations, and are particularly attractive to those in high income tax brackets because of the sheltering aspects. As we all know, sheltering of retirement contributions, especially employer contributions thereto, is an important and controversial item in the tax reform bills under consideration by the Congress.

The 1983 survey of Top 50 firms by the Wyatt Company showed that 39 of the firms had thrift/savings plans involving employer contributions, but with a few of these in "temporary suspension"--presumably recession-related. (The Wyatt Company, Top 50, Exhibit 6A, "Thrift/Savings Plans Covering Salaried

Employees of 50 large Industrial Companies", January 1, 1984, pp. 76-79.) In only 13 of the 39 did employer contributions fully equal or more than equal those of employees. In all of the 39 firms, employee contributions eligible for matching were limited to a specified percent of basic pay, and only a few of the 39 plans provided for immediate vesting of employer contributions. These and other conditions reduce the overall large firm average cost to under 2 percent of payroll. Stock option, employee ownership, and profit sharing, being considerably more concentrated in fewer employees, produce a total capital accumulation plan total cost of approximately 2 percent of payroll in larger private sector firms.

We believe that before including any thrift plan in legislation for a supplemental retirement system for new federal employees, your Committee and the Congress should ascertain the estimated revenue loss to the Treasury and include such loss as a part of the cost of the plan in comparison with the existing Civil Service Retirement System. This is relevant not only to any matching government contribution but to the total employee contribution--both matched and unmatched--as well.

We certainly are in sympathy with the use of public and private pension funds for private sector capital accumulation purposes in light of a national savings rate far below that of some of our foremost international economic competitors. If provision for voluntary contributions to a savings plan without government matching (which is not ruled out in our set of proposed components), the revenue loss cost of such an arrangement should be offset by an appropriate modification of some other part of the pension system formula.

We recognize a definite and significant relationship between the thrift plan proposed in S.1527 and the option offered to employees under the present retirement system to transfer into the new system. Employees not "approaching retirement age" need to be brought under the new system. Our Committee has suggested that in order to avoid too wide a chasm between employees in the old and the new systems and to lower future costs, those employees under age 45 as of the effective date of enactment should mandatorily be brought into the new system, with eventual benefits pro-rated between the old and new formulas based on the years of service under the respective systems. (e.g. assuming factor multipliers and retirement ages suggested above, and assuming initial entry into federal service at age 25, an employee at age 44 with 19 years of service coming into the new system would reach a replacement ratio of 45.25% at age 55, plus Social Security, both fully collectible at age 65; a 35-year-old empoyee would reach a replacement ratio of 36.25% at age 55--10 years under the old system for 16.25% and 20 years under the new system for 20%.)

In addition to the foregoing comments and recommendations regarding the four major cost aspects of S.1527 which we believe need substantial tightening, we would like to submit a few additional items of federal pension system policy which we would urge your Committee and the Congress to consider when enacting a supplemental pension system for new federal hires.

Method and Level of Funding

The overriding need here is for full cost disclosure in such terms as to minimize the continuing argument about meaning and accuracy of figures. To this end we propose that:

> (1) each agency include in its budget the annual estimated actuarial cost as a percent of payroll, exclusive of any employee contributions that might be mandated for the supplemental system; (2) the consolidated balance sheet of the U. S. Government be

> required to reflect the accrued liability for both the new and the old systems, with annual increases in such accrued pension liabilities to be included as costs in the President's unified budget; and (3) full funding of the entry-age normal cost through agency inclusion in annual budgets pursuant to (1) above; (4) a separate trust fund be established for the new plan. This would facilitate the need for "full disclosure" and the monitoring of the fiduciary responsibility of the trustees. In general, it will enhance fiscal discipline.

Various methods for handling the amortization of unfunded liabilities comprise difficult and controversial problems and require further study.

To repeat, all projected pension costs should be faced both initially and continuously thereafter.

To date, most of the analysis of federal pension proposals done by the Congressional Research Service has been based on measuring entry-level normal cost and wage replacement ratios. While these are important evaluation criteria, they do not tell the entire accounting story. It is still necessary to provide financial projections of the Trust Fund assets, liabilities, receipts and disbursements on an accrual basis in order to assess the financial impact of the various proposals. While entry-level normal cost provides the best long-term indicator of adequacy in pension costing, we need an intermediate projection (5-10 years) for the Stevens-Roth bill and the other plans which would show the following: (1) Additions to the Fund, (2) Deductions from the Fund, (3) Net Assets Available for Benefits, (4) Actuarial Present Value of Accumulated Plan Benefits, and (5) Unfunded Liability.

An accounting model for preparing projections of the Trust Fund under the various proposals should be based on GAO supporting instructions to P.L.95-595.

Recovery of "Kicker" Benefits

Retirees who benefited from the compounding effects of the one per cent "kicker" which was in effect from 1969 to 1976 (and costing an estimated $30 to $40 billion over the life expectancies of the retirees and their survivors) should receive no COLAs until the CPI rise is such that past costs attributed to the kicker have been recovered. In addition to over-compensating retirees, the kicker substantially and unfairly widened the gap between retirees and active duty employees. To the extent feasible, the pre-kicker relationship should be restored.

Survivorship and Disability

Survivorship coverage for spouses should be automatic rather than elective; criteria for disability benefit eligibility should be the same as those for Social Security Disability Insurance; and a percentage cap, at a level determined by Congress, should be placed on total disability payments to an individual from private pension plans, Social Security and other employer- or government-sponsored plans--the cap being set at a percentage of final annual pay prior to disability.

Double-counting of Military Service

In legislating the supplemental pension system, the Congress should prohibit the continuation of the practice whereby time spent in military service is counted in the twice in determining the benefits of the federal workers who participated in both programs. In view of the administrative problem in implementing this prohibition, the DOD and the OPM should be mandated to develop the necessary processes to avoid the duplication of retirement credit.

Long-range Consequences

We wish to emphasize the urgency of this problem. We believe the plan that we have proposed after extended study provides the most equitable and affordable approach to a new supplemental plan in which Social Security is a fundamental and universal base. The PEPS supplemental plan offers a pension which is more nearly comparable to those of the private sector. These changes are essential to sound public policy for the future to assure an adequate retirement level for the civil servant and lessen the heavy burden on the American taxpayer.

What started out as a good system in 1920 got out of hand in the 1960s and 1970s. We radically improved the pay of the rank and file civil servant and almost simultaneously introduced indexing. The end result is that our gross liabilities are increasing at about $50 billion per year.

Because of these inequities, it has become increasingly clear that we are threatened by imports from countries which do not have such extraordinarily generous pension systems. We are fast approaching the point of which Adam Smith wrote in the eighteenth century when he stated

> When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue...has always been brought about by bankruptcy; sometimes by an avowed one, but...frequently by a pretended payment.

We played a key role in the shaping of the nation's retirement policy. We know at firsthand of the extraordinary inequities. We believe substantial changes such as we have proposed before this and earlier Congresses must be made in the Civil Service Retirement System--both currently and prospectively. Only if we take these steps can we avert the crisis which we helped to create.

Thank you, Mr. Chairman, and Committee Members. This concludes our statement.

Essential Components of a Supplemental Retirement Plan for Federal Employees Covered Under the Social Security Amendments of 1983, as Proposed by The National Committee on Public Employee Pension Systems (PEPS)

I. Retirement Age:

A. Normal Retirement Age will be the age when unreduced Social Security Old Age Insurance benefits become available (currently age 65 with future increases mandated by Social Security Reform Act of 1983).

B. Early Retirement:

1. Age 62-Normal Retirement Age: Employees with 5 or more years of service will incur a 3 percent reduction in benefit amount for each year prior to Normal Retirement Age that retirement commences.
2. Age 55-61: Employees with 5 or more years of service will incur 6 percent reduction in benefit amount for each year prior to age 62 that retirement commences, in addition to reductions listed in I.B.1.[1]

II. Factor Multiplier:

A. The factor multiplier will be 1.0% times years of service, up to 30 years of service, and

B. 0.5% times years of service, for service beyond 30 years.

III. Final Average Pay:

Final average pay will be defined as average of highest five years' salary.

IV. Vesting:

Full vesting of all credited benefits after 5 years of service.

V. Employee Contributions:

New employees will make no contribution, except to Social Security.

VI. Financing of Supplemental Plan:

All contributions will be made by employing agency, with each agency to include in its budget the annual estimated actuarial cost.

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[1] The reduction in benefits for an individual retiring at age 55 would be 51% (7 times 6 percent plus 3 times 3 percent) with a full actuarial reduction being about 60%, these suggested reductions provide some subsidization of early retirement, thereby allowing some desirable flexibility to both agencies and employees.

VII. Cost of Living Adjustments (COLAs)

Inasmuch as inflation protection will be borne by Social Security portion of retirement benefits, no automatic COLAs are provided in the supplemental portion of the plan.

VIII. Survivorship Benefits:

A. Rather than an elective system as in the present plan, supplemental plan will provide automatic coverage for the surviving spouse[2] at no cost to the employee.
B. Eligibility will be limited to the surviving spouse of a retired employee, or spouse of an employee qualified for retirement but still actively employed.
C. The automatic survivorship benefit will equal 50 percent of supplemental benefit; if death occurs before normal retirement age, benefit will be 50 percent of benefit computed as for early retirement in I.B.1. and 2., above.
D. Employee will be allowed to elect other survivor options on an actuarially equivalent basis.

IX. Disability Benefits:

A. Criteria for eligibility will be the same as those for Social Security Disability Insurance.
B. The disability benefit will be equal to the lesser of the accrued benefit under supplemental plan for credited service to age 65. The benefit will commence after six months of disability.
C. In no event shall total disability payments from Social Security and employer- or government-sponsored plans, including sick leave, exceed a specified percentage[3] of final annual pay prior to disability.
D. The above assumes a full or partial continuation of salary for up to six months under an accident or sickness plan.

X. Funding:

A. The consolidated balance sheet of the U.S. Government will be required to reflect the accrued liability for all federal pension programs. Annual increases in the accrued pension liabilities and current employer payments to the CSRS Trust Fund will be included as costs (budget authority or obligations) in the President's unified budget.
B. The normal cost will be fully funded. Various methods for handling the amoritization of the unfunded liability require further study.

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[2] "Surviving spouse(s)" would need to be defined by the Congress.

[3] As determined by the Congress (e.g., 60, 80, etc. percent).

XI. Coverage of Present (pre-1984) Employees and Retirees:

A. Those employees under age 45 as of January 1, 1986 will be brought into the new system, with a pro-ration applicable to service and consequent contributions to existing CSRS. The remainder of Civil Service employees will be provided a one-time election to join the Social Security system and to be covered by the new CSRS program.

B. For those employees not covered by the supplemental system, COLAs will be based on 100% of the CPI applied to benefits not in excess of the primary Social Security benefit payable to a person who has always had maximum covered earnings and who attains normal retirement age (currently age 65) in the current year. Current employees' initial retirement COLA will not be payable until attainment of age 62.

C. Retirees receiving pensions in excess of the primary Social Security benefit as defined in (b) above and who benefited from the compounding effects ot the "1% COLA Kicker" (in effect from 1969 to 1976) will receive no COLAs until the CPI undergoes a percentage increase equal to that of the affected cohort's COLA percentage increase.

XII. Thrift/Savings Plans:

The foregoing plan components provide adequate retirement income for the federal retiree. Consequently, the Committee believes a government-financed supplemental thrift/savings plan is not required.

NOTE: The foregoing set of components do not purport to deal with all of the issues involved in the creation of a new retirement system connected to Social Security (e.g., early retirement due to reductions in force (RIFs) and severance pay provisions related thereto; the counting of military service in other pension programs; foreign service retirement; retirement from hazardous employment - public safety, air traffic control, etc.)

Senator **Eagleton**. That concludes the hearings on the subject matter. There are other materials that will come in written form and questions to be answered for the record. The record will remain open 1 week or 10 days or so.

[Whereupon, at 12:40 p.m., the committee was recessed, to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

99TH CONGRESS
1ST SESSION

S. 1527

To amend title 5, United States Code, to establish a new retirement and disability plan for Federal employees, postal employees, and Members of Congress, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 30 (legislative day, JULY 16), 1985

Mr. STEVENS (for himself and Mr. ROTH) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

A BILL

To amend title 5, United States Code, to establish a new retirement and disability plan for Federal employees, postal employees, and Members of Congress, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Civil Service Pension Reform Act of 1985".

PURPOSES

SEC. 2. The purposes of this Act are—

(1) to provide Federal employees with a retirement benefits plan which is comparable to good private sector retirement benefits plans;

(2) to promote financial stability and flexibility for the future of each Federal employee;

(3) to ensure a fully funded and financially sound Federal Government retirement benefits plan;

(4) to enhance portability of retirement assets between Federal jobs and jobs outside the Federal Government;

(5) to increase the options of each Federal employee with respect to retirement benefits plans;

(6) to encourage Federal employees to increase personal savings for retirement;

(7) to include Federal employees in the investment decisionmaking process with respect to the assets of the retirement system; and

(8) to extend financial protection from disability to additional Federal employees and to increase such protection for eligible Federal employees.

TITLE I—CIVIL SERVICE PENSION SYSTEM

ESTABLISHMENT

SEC. 101. (a) Title 5, United States Code, is amended by inserting after chapter 83 the following new chapter:

"CHAPTER 84—CIVIL SERVICE PENSION SYSTEM

"SUBCHAPTER I—DEFINITIONS; CIVIL SERVICE PENSION SYSTEM

"Sec.
"8401. Definitions.
"8402. Civil Service Pension System; participation.
"8403. Relationship to the Social Security Act.

"SUBCHAPTER II—BASIC PLAN

"8411. Entitlement to immediate retirement.
"8412. Entitlement to deferred retirement.
"8413. Computation of annuity.
"8414. Reduction for early retirement.
"8415. Reduction for survivor annuities.
"8416. Methods of payments.
"8417. Level benefits option.
"8418. Funding.
"8419. Funding of annuity attributable to military service.

"SUBCHAPTER III—THRIFT SAVINGS PLAN

"8421. Contributions.
"8422. Vesting.
"8423. Entitlement and elections relating to entitlement.
"8424. Annuities: methods of payment; election; and computation.
"8425. Administrative provisions relating to payments and elections.
"8426. Thrift Savings Fund.
"8427. Investment of Thrift Savings Fund.
"8428. Accounting.

"SUBCHAPTER IV—SURVIVOR BENEFITS

"8431. Basic plan spousal benefits relating to the death of a participant or former participant other than an annuitant.
"8432. Basic plan spousal and insurable interest benefits relating to the death of an annuitant.
"8433. Survivor benefits under the thrift savings plan.
"8434. Basic and thrift savings plan survivor benefits relating to marriage after commencement of an annuity.
"8435. Survivor benefits for former spouses: entitlements; amount.
"8436. Survivor benefits for former spouses: elections, deposits and collections, and administrative provisions.
"8437. Termination of entitlement.
"8438. Deposits to the Fund.

"SUBCHAPTER V—DISABILITY BENEFITS

"8441. Definitions.
"8442. Entitlement.
"8443. Computation of benefits.
"8444. Application.
"8445. Medical examinations.
"8446. Offers of alternative employment.
"8447. Recovery or restoration of earning capacity.
"8448. Relationship to workers' compensation.
"8449. Military reserve technicians.

"8450. Administrative provisions.
"8451. Annual accounting; special contingency reserve.
"8452. Federal Employees' Disability Insurance Fund.

"SUBCHAPTER VI—GENERAL AND ADMINISTRATIVE PROVISIONS

"8461. Authority of the Office of Personnel Management.
"8462. Cost-of-living adjustment in basic plan annuities and survivor annuities.
"8463. Rate of benefits.
"8464. Commencement and termination of annuities.
"8465. Waiver, allotment, and assignment of benefits.
"8466. Application for benefits.
"8467. Court orders.
"8468. Annuities and pay on reemployment.

"SUBCHAPTER VII—TRANSITION PROVISIONS

"8471. Treatment of certain individuals subject to the Civil Service Retirement and Disability System.
"8472. Special rules for participants retaining entitlement in the Civil Service Retirement and Disability System.
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"SUBCHAPTER VIII—CIVIL SERVICE THRIFT INVESTMENT MANAGEMENT SYSTEM

"8491. Civil Service Thrift Investment Board.
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"SUBCHAPTER I—DEFINITIONS; CIVIL SERVICE PENSION SYSTEM

"§ 8401. Definitions

"Except as otherwise provided in this chapter, for the purposes of this chapter—

"(1) the term 'account', when used with respect to a participant or annuitant, means an account established and maintained under section 8428(a) of this title;

"(2) the term 'annuitant' means a former participant who is entitled to an annuity under this chapter and who has applied under this chapter for the payment of the annuity to commence;

"(3) the term 'average pay', when used with respect to a participant, means the largest annual rate resulting from averaging the participant's rates of basic pay in effect over any 5 consecutive years of creditable service or, in the case of an annuity under this chapter based on service of less than 5 years, over the total service, with each rate weighted by the period it was in effect;

"(4) the term 'basic pay', when used with respect to a participant--

"(A) means the lesser of—

"(i) the basic pay of the participant established pursuant to law, without regard to any provision of law (except sections 5308 and 5382(b) of this title) limiting the rate of pay actually payable in any pay period (including any provision of law restricting the use of appropriated funds); or

"(ii) the rate of basic pay payable for level I of the Executive Schedule; and

"(B) includes the items described in subparagraphs (A) through (D) of paragraph (3) of section 8331 of this title and does not include the items excluded by such paragraph;

"(5) the term 'Board' means the Civil Service Thrift Investment Board established by section 8491(a) of this title;

"(6) the term 'Civil Service Retirement and Disability Fund' means the Civil Service Retirement and Disability Fund referred to in section 8348 of this title;

"(7) the term 'court', when used with respect to a judgment, decree, order, or other judicial action, means any court of the United States, a State, the District of Columbia, the Commonwealth of Puerto Rico, or a territory or possession of the United States, or any Indian court, having jurisdiction to issue such judgment, decree, or order or to take such other judicial action;

"(8) the term 'Director' means the Director of the Office of Personnel Management;

"(9) the term 'dynamic assumptions' means economic assumptions that are used in determining actuarial costs and liabilities of a retirement system and in anticipating the effects of long-term future—

"(A) investment yields,

"(B) increases in rates of basic pay, and

"(C) rates of price inflation;

"(10) the term 'earnings', when used with respect to the Thrift Savings Fund, means the amount of the gain realized or yield received from the investment of sums in such fund;

"(11) the term 'eligible former spouse', when used with respect to a participant or former participant, means a former spouse of the participant or former participant who was married to the participant or former participant for at least 9 months;

"(12) the term 'employee' means—

"(A) each individual referred to in subparagraphs (A), (E), (F), (H), (I), and (J) of section 8331(1) of this title, including an employee of the United States Park Police and an employee of the United States Secret Service; and

"(B) a Congressional employee as defined in section 2107 of this title, including a temporary Congressional employee;

any of whose service after December 31, 1983, is employment for the purposes of title II of the Social Security Act and chapter 21 of the Internal Revenue Code of 1954, except that such term does not include any individual referred to in clause (i), (ii), (v), (vi), or (ix) of paragraph (1) of section 8331 of this title or in the undesignated material after clause (ix) of such paragraph, any individual excluded under section 8402(b)(2) of this title, or any individual who was subject to subchapter III of chapter 83 of this title on December 31, 1983, and has not commenced participation in the System pursuant to section 8471 of this title;

"(13) the term 'Executive Director' means the Executive Director appointed under section 8493(a)(1) of this title;

"(14) the term 'firefighter' means an employee the duties of whose position—

"(A) are primarily to perform work directly connected with the control and extinguishment of fires; and

"(B) are sufficiently rigorous that employment opportunities are required to be limited to young and physically vigorous individuals, as determined by the Director considering the recommendation of the employing agency;

"(15) the term 'Fund' means the Civil Service Retirement and Disability Fund;

"(16) the term 'Government' means the Federal Government and Gallaudet College;

"(17) the term 'law enforcement officer' means an employee, the duties of whose position—

"(A) are primarily (i) the investigation, apprehension, or detention of individuals suspected or convicted of offenses against the criminal laws of the United States, or (ii) the protection of officials of the United States against threats to personal safety; and

"(B) are sufficiently rigorous that employment opportunities are required to be limited to young and physically vigorous individuals, as determined by the Director considering the recommendation of the employing agency;

"(18) the term 'loss', when used with respect to the Thrift Savings Fund, means the amount of the loss realized from the investment of sums in such fund;

"(19) the term 'lump-sum credit' has the same meaning as provided by section 8331(8) of this title;

"(20) the term 'Member' has the same meaning as provided in section 2106 of this title, except that such term does not include a person who (A) was a Member of Congress on December 31, 1983, and (B) has not commenced participation in the System pursuant to section 8471 of this title;

"(21) the term 'military reserve technician' means a member of one of the reserve components of the

Armed Forces specified in section 261(a) of title 10 who—

"(A) is assigned to a civilian position as a technician in the administration and training of such reserve components or in the maintenance and repair of supplies issued to such reserve components; and

"(B) as a condition of employment in such position, is required to be a member of one of such reserve components serving in a specified military grade;

"(22) the term 'net earnings' means the excess of earnings over losses;

"(23) the term 'net losses' means the excess of losses over earnings;

"(24) the term 'normal cost' means the entry-age normal cost of the provisions of the System which relate to the Fund, computed by the Office in accordance with generally accepted actuarial practice and standards (using dynamic assumptions) and expressed as a level percentage of aggregate basic pay;

"(25) the term 'Office' means the Office of Personnel Management;

"(26) the term 'participant' means an employee or Member or a person who is receiving disability benefits under subchapter V of this chapter;

"(27) the term 'price index' has the same meaning as provided in section 8331(15) of this title;

"(28) the term 'service', when used with respect to a participant or former participant, means—

"(A) employment as a participant;

"(B) subject to section 8419(a) of this title, military service as provided in section 8332(c) of this title; and

"(C) service that is creditable under subchapter III of chapter 83 of this title, but only to the extent provided in section 8472(a) of this title;

"(29) the term 'supplemental liability' means the estimated excess of—

"(A) the actuarial present value of all future benefits payable from the Fund under this chapter, over

"(B) the sum of—

"(i) the actuarial present value of the future contributions to be made on behalf of participants pursuant to section 8418(a) of this title; and "(ii) the balance in the Fund attributable to the System on the date the supplemental liability is determined; and

"(30) the term 'System' means the Civil Service Pension System described in section 8402(a) of this title.

"§ 8402. Civil Service Pension System; participation

"(a) The provisions of this chapter comprise the Civil Service Pension System.

"(b)(1) Except as provided in paragraph (2) of this subsection, each employee and Member shall be a participant in the System.

"(2)(A) The Office may exclude from the operation of this chapter an employee or group of employees in or under an Executive agency whose employment is temporary or intermittent, except an employee whose employment is part-time career employment (as defined in section 3401(2) of this title).

"(B) The Architect of the Capitol may exclude from the operation of this chapter an employee under the Office of the Architect of the Capitol whose employment is temporary or of uncertain duration.

"(C) The Librarian of Congress may exclude from the operation of this chapter an employee under the Library of

Congress whose employment is temporary or of uncertain duration.

"§ 8403. Relationship to the Social Security Act

"Except as otherwise provided in this chapter, the benefits payable under the System are in addition to the benefits payable under the Social Security Act.

"SUBCHAPTER II—BASIC PLAN

"§ 8411. Entitlement to immediate retirement

"(a) An employee or a Member who is separated from Government employment after becoming 55 years of age and completing 10 years of service is entitled to an immediate annuity.

"(b) An employee or a Member who is separated from Government employment after becoming 62 years of age and completing 5 years of service is entitled to an immediate annuity.

"(c) An employee who is separated from Government employment after completing 25 years of service as a law enforcement officer or firefighter, or any combination of such service totaling at least 25 years, is entitled to an immediate annuity.

"(d) An employee who is separated from Government employment after completing 25 years as an air traffic controller is entitled to an immediate annuity.

"(e)(1) Except as provided in paragraphs (2) and (3) of this subsection, any employee who has completed 25 years of service, or is not less than 50 years of age and has completed 20 years of service, and who—

"(A) is separated from Government employment involuntarily, except by removal for cause on charges of misconduct or delinquency, or

"(B) while serving in a geographic area designated by the Director, is voluntarily separated from Government employment during a period that (as determined by the Director)—

"(i) the agency in which the employee is serving is undergoing a major reorganization, a major reduction in force, or a major transfer of function, and

"(ii) a significant percentage of the total number of employees serving in such agency will be separated or subject to an immediate reduction in the rate of basic pay (without regard to subchapter VI of chapter 53 of this title or comparable provisions),

is entitled to an immediate annuity.

"(2) An employee described in paragraph (1)(A) of this subsection is not entitled to an annuity under this subsection if the employee has declined a reasonable offer of another position in the employee's agency for which the employee is qualified and the offered position is not lower than 2 grades or pay levels below the employee's grade or pay level and is within the employee's commuting area.

"(3) Paragraph (1) of this subsection shall not apply to a firefighter, law enforcement officer, or air traffic controller who has completed 25 years of service.

"(f) An annuity authorized by this section is computed under sections 8413 through 8415 of this title.

"§ 8412. Entitlement to deferred retirement

"(a) A participant who is under 55 years of age and separates from Government employment after completing 10 years of service is entitled to an annuity to commence on or after the date the participant becomes 55 years of age but not later than the date the participant becomes 62 years of age, as elected by the participant under rules prescribed by the Office.

"(b) A participant who is under 62 years of age and separates from Government employment after completing 5 years of service and before completing 10 years of service is entitled to an annuity to commence on the date the participant becomes 62 years of age.

"(c) An annuity authorized by this section is computed under sections 8413 through 8415 of this title.

"§ 8413. Computation of annuity

"(a)(1) Except as provided in section 8414 or 8415 of this title, the amount of the annuity an annuitant is entitled to receive under this subchapter shall be equal to the product of 1 percent of the former participant's average pay (while serving as an employee or Member) multiplied by the participant's total service.

"(2) For the purposes of computing the amount of an annuity under paragraph (1) of this subsection, the total service of a participant who separates from Government employment entitled to an immediate annuity or who dies leaving a survivor or survivors entitled to a survivor annuity under this chapter includes days of unused sick leave credited to the participant under a formal leave system to the same extent that unused sick leave is credited in computing an annuity of a person who is subject to subchapter III of chapter 83 of this title, as provided in section 8339(m) of this title.

"(b)(1) A former participant who is entitled to receive an annuity under subsection (c) or (d) of section 8411 of this title and is at least 55 years of age and not more than 62 years of age shall be entitled to receive an annuity supplement, in addition to the amount of the annuity computed under subsection (a) of this section, while the former participant is under 62 years of age.

"(2) The amount of the annuity supplement payable to a former participant under paragraph (1) of this subsection shall be equal to the estimated amount of the benefits that—

"(A) the former participant would be entitled to receive under title II of the Social Security Act if the participant were 62 years of age on the date the annuity referred to in such paragraph commences; and

"(B) is attributable to service referred to in section 8411(c) or 8411(d) of this title, as the case may be,

computed on the date such annuity commences and increased as provided in paragraph (3) of this subsection.

"(3) Effective on January 1 of each year, the amount of the annuity supplement payable to a former participant under this subsection shall be increased by the percentage increase, if any, in the SSA average wage index (as defined in section 215(i)(1)(G) of the Social Security Act) published for November of the preceding year over such index published for November of the next preceding year.

"(c) In computing under this section the annuity of an individual who has performed service on less than a full-time basis, such service shall be credited on a proportional basis equal to the fraction that such service is of full-time service, and the annual rate of basic pay that would be payable for full-time service in the position shall be deemed to be the rate of basic pay.

"§ 8414. Reduction for early retirement

"The annuity computed under section 8413(a) of this title (without regard to this section or section 8415 of this title)—

"(1) for an annuitant, other than an annuitant referred to in paragraph (2) or (3) of this section, who is under 62 years of age on the date on which the annuitant's annuity commences shall be reduced by one-sixth of 1 percent for each month that the annuitant is under such age on such date;

"(2) for an annuitant, other than an annuitant entitled to an immediate annuity under section 8411(e) of this title and an annuitant referred to in paragraph (3) of this subsection, who is at least 55 years of age and is under 62 years of age on the date on which the annuitant's annuity commences and has not completed 30 years of service shall be reduced by five-twelfths of 1 percent for each month that the annuitant is under 62 years of age on such date; and

"(3) for an annuitant who is entitled to an immediate annuity under subsection (c) or (d) of section 8411 of this title or who separated from Government employment as a military reserve technician shall be reduced by five-twelfths of 1 percent for each month that the annuitant is under 55 years of age on the date on which the annuitant's annuity commences.

"§ 8415. Reduction for survivor annuities

"(a) The annuity of an annuitant computed under section 8413 of this title and, if appropriate, under section 8414 of this title shall be reduced by an estimated amount such that the actuarial present value of the retirement benefits expected to be payable to the annuitant under this subchapter and all survivor benefits expected to be payable out of the Fund with respect to the annuitant is equal to the actuarial present value of the retirement benefits that would be expected to be payable under this subchapter to the annuitant pursuant to the method referred to in section 8416(a)(2)(A) of this title, as determined under regulations prescribed by the Office.

"(b) A reduction in the annuity of an annuitant pursuant to subsection (a) of this section shall be adjusted, as appropriate to carry out such subsection, to reflect any change in circumstances relating to entitlement to a survivor annuity, including any election made pursuant to section 8434(a), 8436(b), or 8436(c) of this title.

"§ 8416. Methods of Payment

"(a)(1) The Office shall prescribe methods of payment of annuities under this subchapter.

"(2) The methods of payment prescribed under paragraph (1) of this subsection shall include, but not be limited to—

"(A) a method which provides for the payment of a monthly annuity only to an annuitant during the life of the annuitant;

"(B) a method which provides for the payment of a monthly annuity to an annuitant and a monthly survivor annuity equal to 50 percent of the annuitant's annuity on the date of the annuitant's death (computed without regard to an election under section 8417(a) of this title) to the annuitant's surviving spouse, if any; and

"(C) a method which provides for the payment of a monthly annuity to an annuitant and a monthly survivor annuity equal to 50 percent of the annuitant's annuity on the date of the annuitant's death (computed without regard to an election under section 8417(a) of this title) to an individual who is designated by the annuitant and who has an insurable interest in the annuitant.

"(b)(1) Subject to paragraphs (2) and (3) of this subsection—

"(A) under such regulations as the Office shall prescribe, a participant or former participant who is applying for an annuity under this subchapter to commence shall elect one of the methods of payment prescribed by the Office under subsection (a) of this section; and

"(B) the annuity of an annuitant under this subchapter shall be paid in accordance with the method of payment elected by the annuitant pursuant to subparagraph (A) of this paragraph.

"(2)(A) A participant or former participant who is married on the date on which the participant or former participant applies for an annuity under this subchapter to commence may elect a method of payment other than the method described in subsection (a)(2)(B) of this section only if the participant or former participant and the spouse of the participant or former participant jointly waive a survivor annuity under the method described in such subsection (a)(2)(B).

"(B) A waiver shall not be effective for the purpose of subparagraph (A) of this paragraph unless the waiver is made in writing, is notarized, and is filed with the Office on or before the date the annuity to which the waiver relates commences.

"(C) A waiver made in accordance with this paragraph shall be irrevocable.

"(3) In the case of an annuitant who is subject to paragraph (2)(A) of this subsection and fails to make an election under paragraph (1) of this subsection, an annuity and survivor annuity shall be paid under the method of payment described in subsection (a)(2)(B) of this section.

"(4) A participant or former participant may elect the method prescribed under subsection (a)(2)(C) of this section only if the participant or former participant is in good health on the date the election is made, as determined by the Office.

"§ 8417. Level benefits option

"(a) Under regulations prescribed by the Office, an annuity payable under this subchapter to a participant who is separating from Government employment entitled to an immediate annuity under subsection (a) of section 8411 of this title and is less than 62 years of age may be adjusted as provided in subsection (b) of this section, if elected by the participant on or before the date of separation.

"(b)(1) Subject to paragraph (2) of this subsection, an annuity payable under this subchapter to an annuitant who has made an election authorized by subsection (a) of this section may be increased during the period the annuitant is not less than 55 years of age and is less than 62 years of age and may be reduced on and after the date the annuitant is not less than 62 years of age as appropriate to provide the annuitant an annuity under this subchapter, during each month of such period, in an amount which approximately equals the total amount of the monthly benefits payable to the annuitant under this subchapter and section 202(a) of the Social Security Act after such date.

"(2) The actuarial present value of the benefits expected to be paid under this subchapter to the annuitant as provided in paragraph (1) of this subsection on and after the date the annuitant becomes 55 years of age may not exceed the actuarial present value of the benefits that would be expected to be paid under this subchapter to such participant on and after such date if the adjustments authorized by such paragraph were not made, as determined under regulations prescribed by the Office.

"§ 8418. Funding

"(a)(1) Each agency of the Government employing a participant shall contribute to the Fund an amount equal to the sum of—

"(A) the normal cost, as determined by the Office, of (i) each participant who is employed by the agency, and (ii) each disabled participant who is entitled to benefits under section 8442(a) of this title and was employed by the agency on the date the participant became disabled (computed using average pay as increased in accordance with section 8442(b)(2)(C) of this title); and

"(B) the normal cost, as determined by the Office, of the annuity supplement under section 8413(b) of this title for each law enforcement officer, firefighter, and air traffic controller who is employed by the agency.

"(2) The contribution required by paragraph (1) of this subsection to be made by an agency shall be made from the appropriation or fund used to pay the agency's participants, or, in the case of an elected participant, from an appropriation or fund available for payment of other salaries of the office or establishment of the participant. In the case of a participant in the legislative branch who is paid by the Clerk of the House of Representatives, contributions for the benefit of such participant shall be paid from the contingent fund of the House of Representatives.

"(b)(1) The Office shall compute—

"(A) the amount of the supplemental liability of the Fund relating to participants and annuitants other than participants and annuitants referred to in subparagraph (B) of this paragraph, and

"(B) the amount of the supplemental liability of the Fund relating to participants and annuitants who are active or retired officers or employees of the United States Postal Service,

as of the close of each fiscal year beginning after September 30, 1987.

"(2) The amounts of any supplemental liability—

"(A) computed pursuant to paragraph (1)(A) of this subsection with respect to participants and annuitants referred to in such paragraph (1)(A) of this subsection, and

"(B) computed pursuant to paragraph (1)(B) of this subsection with respect to participants and annuitants referred to in such paragraph (1)(B),

shall each be amortized in thirty annual installments.

"(3) At the end of each fiscal year, the Office shall notify—

"(A) the Secretary of the Treasury of the amount of the annual installment computed under paragraph (2)(A) of this subsection for such fiscal year, and

"(B) the Postmaster General of the United States of the amount of the annual installment computed pursuant to paragraph (2)(B) of this subsection for such fiscal year.

"(4)(A) Before closing the accounts for a fiscal year, the Secretary of the Treasury shall credit the amount of the annual installment computed for such fiscal year pursuant to paragraph (2)(A) to the Fund, as a Government contribution, out of any money in the Treasury of the United States not otherwise appropriated.

"(B) Upon receiving a notice required by paragraph (3)(B) of this subsection, the United States Postal Service shall pay to the Fund the amount of the annual installment specified in the notice.

"(5) For the purpose of carrying out paragraph (1) of this subsection with respect to any fiscal year, the Office may—

"(A) require the Board of Actuaries of the Civil Service Retirement System to make actuarial determinations and valuations, make recommendations, and maintain records in the same manner as provided in section 8347(f) of this title; and

"(B) may use the latest actuarial determinations and valuations made by such Board of Actuaries.

"§ 8419. Funding of annuity attributable to military service

"(a) Except in the case of an individual making an election under section 8471(a)(1)(A) of this title, a participant's or former participant's service shall include credit for military service as provided in section 8332(c) of this title without regard to whether the participant or former participant has made a deposit covering such military service as provided in section 8334(j) of this title.

"(b) Before closing the accounts for a fiscal year, the Secretary of the Treasury shall reimburse the Fund from sums in the Department of Defense Military Retirement Fund (established by section 1461(a) of title 10), which are hereby made available to pay the reimbursement, for the normal cost relating to the creditable military service of employees and Members who became participants during such fiscal year, actuarially adjusted to the date of payment, as determined by the Office.

"(c) At the end of each fiscal year the Office shall compute the amount of the reimbursement required by subsection (b) of this section for the fiscal year and shall notify the Secretary of the Treasury of that amount.

"SUBCHAPTER III—THRIFT SAVINGS PLAN

"§ 8421. Contributions

"(a)(1) Each participant may contribute to the Thrift Savings Fund in any year an amount not exceeding 10 percent of the participant's annual rate of basic pay.

"(2) Each participant receiving disability benefits under subchapter V of this chapter may, until becoming 62 years of age (in the case of a person who is disabled within the meaning of section 8441(4)(A) of this title) or until becoming 55 years of age (in the case of a person who is disabled within the meaning of section 8441(4)(B) of this title), contribute to the Thrift Savings Fund in any year an amount not exceeding 10 percent of the amount of the former participant's disability benefits payable under such subchapter during such year.

"(3) Any contribution under this subsection shall be made only pursuant to a program of regular contributions under regulations prescribed by the Board.

"(4) At least once each year, a participant may modify the amount contributed pursuant to paragraph (1) or (2) of this subsection, as the case may be, under regulations prescribed by the Board.

"(b) The employing agency of a participant who contributes to the Thrift Savings Fund under subsection (a) of this section for any pay period, or, in the case of a disabled participant who contributes to such fund under such subsection for any disability benefits payment period, the employing agency of the participant on the date the participant became disabled (as defined in section 8441(4) of this title), shall contribute to the Thrift Savings Fund for the benefit of such participant or disabled participant at the end of such period an amount equal to such portion of the amount of the participant's contribution as does not exceed 5 percent of the amount of the gross pay or gross disability benefits, as the case may be, payable for such period.

"(c) The sums required to be contributed to the Thrift Savings Fund by an employing agency under subsection (b) of this section for the benefit of a participant shall be paid from the appropriations or funds available to such agency to pay the basic pay of participants or, in the case of an elected participant, from an appropriation or fund available for payment of other salaries of the participant's office or establishment. In the case of a participant in the legislative branch who is paid by the Clerk of the House of Representatives, contributions for the benefit of such participant shall be paid from the contingent fund of the House of Representatives.

"(d) For purposes of the Internal Revenue Code of 1954—

"(1) any amount of the participant's pay which is contributed to the Thrift Savings Fund, and the amount of the employing agency's matching contributions, shall not be included in the gross income of the participant; and

"(2) the Thrift Savings Fund shall be treated, for purposes of determining when amounts in such Fund are included in the income of any participant, as described in section 401(a) of such Code.

"(e) Subsection (d)(1) of this section shall not be construed to provide that any amount of the participant's pay which is contributed to the Thrift Savings Fund shall not be included in the term 'wages' for purposes of section 209 of the Social Security Act or section 3121(a) of the Internal Revenue Code of 1954.

"§ 8422. Vesting

"(a)(1) A participant who separates from Government employment shall be entitled to an amount equal to—

"(A) the total amount of the contributions made under section 8421(a) of this title plus the total amount of the net earnings in the Thrift Savings Fund, or minus the total amount of the net losses, attributable to such contributions; and

"(B) the applicable percentage of the amount equal to the total amount contributed to the Thrift Savings Fund for the benefit of the participant under section 8421(b) of this title plus the total amount of the net earnings in the Thrift Savings Fund, or minus the total amount of the net losses, attributable to such contributions, as provided in subsection (b) of this section.

"(2) The amount to which a participant is entitled under paragraph (1) of this subsection shall be payable in accordance with the election made by the participant pursuant to section 8423 of this title.

"(b)(1) For the purpose of subsection (a)(1)(B) of this section, except as provided in paragraph (2) of this subsection, the applicable percentage for a participant separating from Government employment after having been a participant in the System for a period set forth under column I of the table below is the percentage set forth under column II of the table below opposite the description of such period:

"Column I Period for which the participant has been a participant in the System:	Column II Applicable percentage:
Less than 1 year	0
Not less than 1 year, but less than 2 years	20
Not less than 2 years, but less than 3 years	40
Not less than 3 years, but less than 4 years	60
Not less than 4 years, but less than 5 years	80
Not less than 5 years	100.

"(2) For the purposes of subsection (a)(1)(B) of this section—

"(A) the percentage applicable in the case of any participant who dies while employed by the Government shall be 100 percent; and

"(B) in the case of a participant making contributions under section 8421(a)(2) of this title, the period for which the person has been a participant in the System shall include periods for which such contributions were made.

"(c) When an election is made by a participant under section 8423(c) of this title, the amount equal to the excess of—

"(1) the sum of—

"(A) the amounts contributed to the Thrift Savings Fund with respect to the participant under section 8421 of this title; and

"(B) the net earnings in the Thrift Savings Fund attributable to such contributions, over

"(2) the amount in the Thrift Savings Fund paid or reserved for payment to or with respect to the participant pursuant to section 8423(c) of this title,

shall be transferred to the Treasury of the United States for credit to Miscellaneous Receipts.

"§ 8423. Entitlement and elections relating to entitlement

"(a) Any participant who separates from Government employment entitled to an immediate annuity under section 8411 of this title is entitled and may elect—

"(1) to receive an immediate annuity from the Thrift Savings Fund;

"(2) to defer the commencement of the payment of an annuity from the Thrift Savings Fund until such date as the participant specifies;

"(3) to withdraw, in one or more payments, the amount of the balance credited to the participant's account in the Thrift Savings Fund; or

"(4) to transfer the amount of the balance in the account to an individual retirement account or other qualified plan (within the meaning of the Internal Revenue Code of 1954) of the participant.

"(b) Any participant who separates from Government employment entitled to a deferred annuity under section 8412 of this title is entitled and may elect—

"(1) to receive an annuity from the Thrift Savings Fund to commence on the first date the participant is entitled to receive the deferred annuity;

"(2) to defer the commencement of the payment of an annuity from the Thrift Savings Fund until a date after the first date the participant is entitled to receive the deferred annuity, as specified by the participant;

"(3) to withdraw in one or more payments, on or after the first date the participant is entitled to receive the deferred annuity, the amount of the balance credited to the participant's account in the Thrift Savings Fund; or

"(4) to transfer the amount of the balance in the account to an individual retirement account or other qualified plan (within the meaning of the Internal Revenue Code of 1954) of the participant.

"(c) Any participant who separates from Government employment before becoming entitled to an annuity under section 8411 or 8412 of this title is entitled and may elect—

"(1) to receive an annuity from the Thrift Savings Fund to commence when the participant becomes 62 years of age;

"(2) to withdraw, in one or more payments, the amount computed under section 8422(a)(1) of this title, payable when the participant becomes 62 years of age; or

"(3) to transfer such amount to an individual retirement account or other qualified plan (within the meaning of the Internal Revenue Code of 1954) of the participant.

"(d)(1) Subject to paragraph (2) of this subsection, any participant making an election pursuant to subsection (a)(2) or (b)(2) of this section may modify the date specified in the election or in a previous modification under this subsection.

"(2) Any modification of an election under paragraph (1) of this subsection may not be made on or after the date specified in the election or the latest modification made under such paragraph and may not specify a date for the commencement of annuity payments earlier than one month after the date the modification is filed with the Executive Director.

"§ 8424. Annuities: methods of payment; election; and computation

"(a)(1) The Board shall prescribe methods of payment of annuities under this subchapter.

"(2) The methods of payment prescribed under paragraph (1) of this subsection shall include, but not be limited to—

"(A) a method which provides for the payment of a monthly annuity only to an annuitant during the life of the annuitant;

"(B) a method which provides for the payment of a monthly annuity to an annuitant for the joint lives of the annuitant and the spouse of the annuitant and an appropriate monthly annuity to the one of them who survives the other of them for the life of the survivor;

"(C) a method described in subparagraph (A) of this paragraph which provides annual increases in the amount of the annuity payable;

"(D) a method described in subparagraph (B) of this paragraph which provides annual increases in the amount of the annuity payable; and

"(E) a method providing for the payment of a monthly annuity—

"(i) to the annuitant for the joint lives of the annuitant and an individual, designated by the annuitant under regulations prescribed by the Board, who has an insurable interest in the annuitant; and

"(ii) to the one of them who survives the other of them for the life of the survivor.

"(b) Subject to paragraph (2) of this subsection, under such regulations as the Board shall prescribe, an annuitant electing under section 8423 of this title to receive an annuity from the Thrift Savings Fund shall elect, on or before the date on which the annuitant's annuity under this subchapter commences, one of the methods of payment prescribed by the Board under subsection (a) of this section.

"(c) The amount of an annuity payable under this subchapter pursuant to the method elected under subsection (b) of this section shall be determined on an actuarial basis under regulations prescribed by the Board.

"§ 8425. Administrative provisions relating to payments and elections

"(a) The Executive Director shall make or provide for payments and transfers in accordance with an election of a participant under section 8423 or 8424(b) of this title.

"(b) Any election under section 8423 or 8424(b) of this title shall be in writing and shall be filed with the Executive Director in accordance with regulations prescribed by the Board.

"(c) Notwithstanding any other provision of this section, an election or modification of an election under any provision of this subchapter shall not be effective if the election or modification would result in a violation of the terms of an applicable court decree of divorce, annulment, or legal separation, or the terms of any court order or court-approved property settlement agreement incident to a court decree of divorce, annulment, or legal separation, as determined by the Executive Director.

"§ 8426. Thrift Savings Fund

"(a) There is established in the Treasury of the United States a Thrift Savings Fund.

"(b) The Thrift Savings Fund consists of the sum of all amounts contributed under section 8421 of this title increased by the total net earnings from investments of sums in the Thrift Savings Fund or reduced by the total net losses from investments of the Thrift Savings Fund.

"(c) The sums in the Thrift Savings Fund are appropriated and shall remain available without fiscal year limitation—

"(1) to invest under section 8427 of this title;

"(2) to pay benefits under this subchapter;

"(3) to pay the administrative expenses of the Civil Service Thrift Investment Management System prescribed in subchapter VIII of this chapter; and

"(4) to make loans to participants as authorized under subsection (e) of this section.

"(d)(1) Except as provided in paragraph (2) of this subsection, sums in the Thrift Savings Fund are not subject to execution, levy, attachment, garnishment, or other legal process.

"(2) Moneys due or payable from the Thrift Savings Fund to any individual and, in the case of an individual who is a participant, moneys which the individual would be entitled to receive under section 8422 of this title upon separation from Government employment shall be subject to legal process for the enforcement of the individual's legal obligations to provide child support or make alimony payments as provided in section 459 of the Social Security Act (42 U.S.C. 659) or to pay any indebtedness of the individual to the United States.

"(e) The Board shall establish a program to make loans from the Thrift Savings Fund to a participant in case of financial hardship and shall prescribe regulations to carry out such program. Any such loan shall be made only out of sums contributed to the Thrift Savings Fund by the participant and net earnings attributable to such sums.

"(f) The sums in the Thrift Savings Fund shall not be appropriated and may not be used for any purpose other than the purposes specified in this section.

"§ 8427. Investment of Thrift Savings Fund

"(a) For the purposes of this section—

"(1) the term 'Common Stock Index Investment Fund' means the Common Stock Investment Fund established under subsection (b)(1)(C) of this section;

"(2) the term 'equity capital' means common and preferred stock, surplus, undivided profits, contingency reserves, and other capital reserves;

"(3) the term 'Fixed Income Investment Fund' means the Fixed Income Investment Fund established under subsection (b)(1)(B) of this section;

"(4) the term 'Government Securities Investment Fund' means the Government Securities Investment Fund established under subsection (b)(1)(A) of this section;

"(5) the term 'net worth' means capital, paid-in and contributed surplus, unassigned surplus, contingency reserves, group contingency reserves, and special reserves;

"(6) the term 'plan' means an employee benefit plan, as defined in section 3(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(3));

"(7) the term 'qualified professional asset manager' means—

"(A) a bank, as defined in section 202(a)(2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(2)) which—

"(i) has the power to manage, acquire, or dispose of assets of a plan; and

"(ii) has, as of the last day of its latest fiscal year ending before the date of a determination for the purpose of this clause, equity capital in excess of $1,000,000;

"(B) a savings and loan association, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, which—

"(i) has applied for and been granted trust powers to manage, acquire, or dispose of assets of a plan by a State or Government authority having supervision over savings and loan associations; and

"(ii) has, as of the last day of its latest fiscal year ending before the date of a determination for the purpose of this clause, equity capital or net worth in excess of $1,000,000;

"(C) an insurance company which—

"(i) is qualified under the laws of more than one State to manage, acquire, or dispose of any assets of a plan;

"(ii) has, as of the last day of its latest fiscal year ending before the date of a determination for the purpose of this clause, net worth in excess of $1,000,000; and "(iii) is subject to supervision and examination by a State authority having supervision over insurance companies; or

"(D) an investment adviser registered under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3) if the investment adviser has, on the last day of its latest fiscal year ending before the date of a determination for the purpose of this subparagraph, total client assets under its management and control in excess of $50,000,000, and—

"(i) the investment adviser has, on such day, shareholder's or partner's equity in excess of $750,000; or

"(ii) payment of all of the investment adviser's liabilities, including any liabilities which may arise by reason of a breach or violation of a duty described in section 8497 of this title, is unconditionally guaranteed by—

"(I) a person who directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the investment adviser and who has, on the last day of the person's latest fiscal year ending before the date of a determination for the purpose of this clause, shareholder's or partner's equity in an amount which, when added to the amount of the shareholder's or partner's equity of the investment adviser on such day, exceeds $750,000;

"(II) a qualified professional asset manager described in subparagraph (A), (B), or (C) of this paragraph; or

"(III) a broker or dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) that has, on the last day of the broker's or dealer's latest fiscal year ending before the date of a determination for the purpose of this clause, net worth in excess of $750,000; and

"(8) the term 'shareholder's or partner's equity', when used in paragraph (7)(D) of this subsection with respect to an investment adviser or a person who is affiliated with the investment adviser in a manner described in clause (ii)(I) of such paragraph (7)(D), means the equity shown in the most recent balance sheet prepared for such investment adviser or affiliated person, in accordance with generally accepted accounting principles, within 2 years before the date on which the investment adviser's status as a qualified professional asset manager is determined for the purposes of this section.

"(b)(1) The Board shall establish—

"(A) a Government Securities Investment Fund under which sums in the Thrift Savings Fund are invested in securities of the United States Government issued as provided in subsection (g) of this section;

"(B) a Fixed Income Investment Fund under which sums in the Thrift Savings Fund are invested in insurance contracts, certificates of deposits, or other instruments or obligations which (i) are issued or selected by qualified professional asset managers, and (ii) return the amount invested and pay interest, at a specified rate or rates, on that amount during a specified period of time;

"(C) a Common Stock Index Investment Fund as provided in paragraph (2) of this subsection; and

"(D) such other investment funds as the Board determines to be appropriate for the purposes of this subchapter.

"(2)(A) The Board shall define an index which—

"(i) consists of all of the common stocks that are publicly listed and traded on one or more national securities exchanges, or

"(ii) is a commonly recognized index comprised of common stock the aggregate market value of which is at least 50 percent of the aggregate market value of all common stocks that are publicly listed and traded on one or more national securities exchanges.

"(B) The Common Stock Investment Fund shall be invested in each stock that is included in the index defined under subparagraph (A) of this paragraph such that, to the extent practicable, the percentage of the Common Stock Investment Fund that is invested in that stock is the same as the percentage determined by dividing the aggregate market value of all shares of that stock by the aggregate market value of all shares of all stock included in such index.

"(c)(1) The Executive Director shall invest in the Government Securities Investment Fund the sums which are in the Thrift Savings Fund, are available for investment, and are not to be invested in an investment fund referred to in subsection (b)(1)(B), (b)(1)(C), or (b)(1)(D) of this section pursuant to an election made under subsection (d) of this section.

"(2) Except as provided in subsection (e) of this section, the Executive Director shall invest sums available in the

Thrift Savings Fund for investment as provided in elections made under subsection (d) of this section.

"(d)(1) Except as provided in subsection (e) of this section, at least once each year, a participant or former participant may elect the investment funds referred to in subsection (b) of this section into which the sums in the Thrift Savings Fund credited to the account of such participant or former participant are to be invested or reinvested.

"(2) The election may be made by a participant or former participant under paragraph (1) of this subsection only in accordance with regulations prescribed by the Board and within such period after the date the participant's or former participant's annual statement is transmitted to the participant or former participant pursuant to section 8428(b) of this title as the Board shall prescribe in such regulations.

"(e)(1)(A) The Executive Director shall invest a percentage of the total amount that—

"(i) is contributed to the Thrift Savings Fund by a participant under section 8421(a) of this title during a year described under column I of the first table of minimum Government securities investments set out in subparagraph (B) of this paragraph, and

"(ii) is available for investment,

in the Government Securities Investment Fund as provided under column II of the table opposite the description of such year.

"(B) For the purposes of subparagraph (A) of this paragraph, the first table of minimum Government securities investments is as follows:

"Column I	Column II
Year:	Minimum percentage of the amounts contributed by a participant for each month of such year to be invested in the Government Securities Investment Fund:
1987	100
1988	80
1989	60
1990	40
1991	20.

"(2)(A) The Executive Director shall invest a percentage of the total amount that—

"(i) is contributed to the Thrift Savings Fund by the Government for the benefit of a participant pursuant to section 8421(b) of this title during a year described under column I of the second table of minimum Government securities investments set out in subparagraph (B) of this paragraph, and

"(ii) is available for investment,

in the Government Securities Investment Fund as provided under column II of the table opposite the description of such year.

"(B) For the purposes of subparagraph (A) of this paragraph, the second table of minimum Government securities investments is as follows:

"Column I	"Column II
Year:	Minimum percentage of the amounts contributed for the benefit of a participant for each month of such year to be invested in the Government Securities Investment Fund:
1987-1992	100
1993	80
1994	60
1995	40
1996	20.

"(3) All sums credited to the Thrift Savings Fund pursuant to section 8473(b) of this title shall be invested in the Government Securities Investment Fund.

"(4) The sums which are invested in the Government Securities Investment Fund as required by this subsection and are returned to the Thrift Savings Fund after maturity of the securities purchased with such sums, and the amounts earned on the investment of such sums, shall be reinvested in the Government Securities Investment Fund.

"(f) The Secretary of the Treasury shall issue notes under section 3103 of title 31 as appropriate to meet the investment needs of the Thrift Savings Fund under this section. The notes shall have a 2-year maturity, shall be redeemable at par, and shall bear interest at a rate equal to the average market yield, computed as of the end of the calendar month next preceding the date of the issue, of all 2-year notes then forming a part of the public debt of the United States. If the average market yield is not a multiple of ⅛ of 1 percent, the rate of interest on the obligations shall be the multiple of ⅛ of 1 percent nearest the average market yield.

"§ 8428. Accounting

"(a)(1) The Executive Director shall establish and maintain an account for each participant making contributions under section 8421(a) of this title.

"(2) The balance in the account of a participant or former participant at any time is the excess of—

"(A) the sum of—

"(i) all contributions made to the Thrift Savings Fund by the participant or former participant under section 8421(a) of this title;

"(ii) all contributions made to such fund for the benefit of the participant or former participant under section 8421(b) of this title;

"(iii) the amounts transferred to such fund with respect to the participant or former participant under section 8473(b) of this title; and

"(iv) the total amount of the allocations made to and reductions made in the account pursuant to paragraph (3) of this section, over

"(B) the amounts paid out of the Thrift Savings Fund with respect to such participant or former participant under this subchapter and subchapter IV of this title.

"(3) Pursuant to regulations prescribed by the Board, the Executive Director shall allocate to the account of each participant or former participant an amount equal to a pro rata share of the net earnings and net losses from each investment of sums in the Thrift Savings Fund attributable to sums credited to the account of such participant, reduced by an appropriate share of the administrative expenses of the Civil Service Thrift Investment Management System prescribed in subchapter VIII of this chapter, as determined by the Executive Director.

"(b) The Executive Director shall provide each participant and former participant an annual statement of the balance in the participant's or former participant's account.

"(c)(1) For the purposes of this subsection, the term 'qualified public accountant' shall have the same meaning as provided in section 103(a)(3)(D) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1024(a)(3)(D)).

"(2) The Executive Director shall annually engage, on behalf of all participants, an independent qualified public accountant, who shall conduct an examination of any accounts established under subsection (a) of this section and of other books and records maintained in the administration of this subchapter as the accountant considers necessary to enable the accountant to make the determination required by paragraph (3) of this subsection. The examination shall be conducted in accordance with generally accepted auditing standards and shall involve such tests of the accounts, books, and records as the independent qualified public accountant considers necessary.

"(3) The independent qualified public accountant conducting an examination under paragraph (2) of this subsection shall determine whether the accounts, books, and records referred to in such paragraph have been maintained in conformity with generally accepted accounting principles applied on a basis consistent with the application of such principles during the examination conducted under such paragraph during the preceding year. The accountant shall transmit to the Board a report on his examination, including his determination under this paragraph.

"(4) In making a determination under paragraph (3) of this subsection, the accountant may rely on the correctness of any actuarial matter certified by an enrolled actuary, if the accountant states his reliance in the report transmitted to the Board under such paragraph.

"SUBCHAPTER IV—SURVIVOR BENEFITS

"§ 8431. Basic plan spousal benefits relating to the death of a participant or former participant other than an annuitant

"(a)(1) If a participant dies after performing 5 or more years of service and before separating from Government employment and the participant has satisfied the age and service requirements for retirement entitled to an immediate annuity under section 8411 of this title before the date of death, the surviving spouse of a deceased participant shall be entitled to a survivor annuity payable out of the Fund.

"(2) If a participant dies after performing 5 or more years of service and before separating from Government employment and the participant has not satisfied the age and service requirements for retirement entitled to an immediate annuity under section 8411 of this title before the date of death, the surviving spouse of a deceased participant shall be entitled to a survivor annuity payable out of the Fund. The survivor annuity shall commence on the first date the participant could have retired entitled to an immediate annuity under section 8411 of this title if the participant had continued to live and had continued to be a participant until such date.

"(3) The amount of the survivor annuity payable under paragraph (1) or (2) of this subsection to the surviving spouse of a deceased participant shall be equal to 50 percent of the annuity computed with respect to the deceased participant pursuant to sections 8413, 8414, and 8415 of this title as if the participant had retired from Government employment on the day before the date of death and had elected the method of payment described in section 8416(a)(2)(B) of this title.

"(b)(1) If a former participant dies entitled to a deferred annuity under section 8412 of this title before payment of an annuity under subchapter II of this chapter to the former participant commences, the surviving spouse of the deceased former participant is entitled to a survivor annuity payable out of the Fund.

"(2) The amount of the survivor annuity payable under paragraph (1) of this subsection to the surviving spouse of a deceased former participant shall be equal to 50 percent of the annuity which the deceased former participant would have been entitled to receive under such section if the deceased former participant—

"(A) had been 55 years of age on the day before the date of death, or

"(B) in the case of a former participant who was 55 years of age or older on such day and was not receiving such annuity, had commenced to receive such deferred annuity on such day,

computed under sections 8413, 8414, and 8415 of this title.

"§ 8432. Basic plan spousal and insurable interest benefits relating to the death of an annuitant

"A survivor annuity shall be paid out of the Fund with respect to a deceased annuitant—

"(1) in accordance with the method of payment elected by the annuitant under section 8416 of this title;

"(2) as provided in subsection (b)(3) of such section; or

"(3) in accordance with an election made by the annuitant under section 8434(a) or 8436(c) of this title.

"§ 8433. Survivor benefits under the thrift savings plan

"(a) A survivor annuity shall be paid out of the Thrift Savings Fund with respect to a deceased annuitant as provided under a method of payment of annuities elected by the annuitant under section 8424(b) of this title or in accordance with an election made by the annuitant under section 8434(a) or 8436(c) of this title. The amount of the survivor annuity shall be determined on an actuarial basis under regulations prescribed by the Board.

"(b)(1) Except as provided in subsection (d) of this section, the amount in the account established and maintained for a deceased participant or deceased former participant (other than a deceased annuitant) pursuant to section 8428(a) of this title, determined on the date of an election under subsection (c) of this section, shall, subject to the limits of the entitlement set out in section 8422(a)(1) of this title (without regard to section 8422(a)(2) of this title), be paid as provided in paragraph (2) of this subsection.

"(2)(A) Except as provided in subparagraph (B) of this paragraph, payment under paragraph (1) of this subsection shall be made to the surviving spouse of the deceased participant or former participant pursuant to the method elected under subsection (c) of this section.

"(B) If a deceased participant or former participant referred to in paragraph (1) of this subsection is not survived by a spouse, payment under such paragraph shall be made to—

"(i) any individual who has an insurable interest in the participant or former participant and has been designated by the participant for the purpose of such paragraph under regulations prescribed by the Board; or

"(ii) if the deceased participant or former participant did not make a designation as provided in clause (i) of this subparagraph, to the estate of the deceased participant or former participant.

"(c) A surviving spouse entitled to payment of benefits under subsection (b) of this section may elect—

"(1) to receive an annuity from the Fund payable monthly for life;

"(2) to transfer the amount referred to in such subsection to an individual retirement account (within the meaning of the Internal Revenue Code of 1954) of the surviving spouse; or

"(3) to withdraw such amount in one or more payments.

"(d) Any amount required for the payment of a survivor annuity with respect to a deceased participant or deceased former participant out of the Thrift Savings Fund pursuant to section 8435 of this title shall be deducted and withheld from a distribution made with respect to the deceased participant or deceased former participant pursuant to subsection (b) of this section. The amount deducted and withheld shall be maintained in the Thrift Savings Fund until expended in payment of the survivor annuity or until the survivor annuity terminates. Any sums remaining from the amount deducted and withheld after the termination of the survivor annuity, plus net earnings realized from investment of such amount, shall be distributed as provided in subsection (b) of this section.

"§ 8434. Basic and thrift savings plan survivor benefits relating to marriage after commencement of an annuity

"(a) If an annuitant—

"(1) is married on the date that the annuitant applies for payment of an annuity under subchapter II of this chapter to commence, the marriage terminates, and the annuitant remarries, or

"(2) is not married on such date and marries after such date,

the annuitant may irrevocably elect during the later marriage to provide an annuity for such annuitant's spouse under the method of payment described in section 8416(a)(2)(B) or subparagraph (B) or (D) of section 8424(a)(2) of this title. An election under this subparagraph shall be made in a signed writing received by the Office within 2 years after the date of the remarriage or marriage, as the case may be.

"(b) An election under subsection (a) of this section shall be effective the first day of the second month beginning after the election is received by the Office (in the case of a survivor annuity payable out of the Fund) or the Executive Director (in the case of a survivor annuity payable out of the Thrift Savings Fund), but not earlier than 9 months after the date of the remarriage referred to in paragraph (1) of such subsection or the date of the marriage referred to in paragraph (2) of such subsection.

"(c) An annuitant making an election under subsection (a) of this section to provide a survivor annuity payable out of the Fund shall, within 2 years after the date of the remarriage referred to in paragraph (1) of such subsection or the date of the marriage referred to in paragraph (2) of such subsection, deposit in the Fund an amount determined by the Office, as nearly as may be administratively feasible, to reflect the amount by which the annuity of such annuitant would have been reduced if the election had been in effect since—

"(1) the date that payment of an annuity to the annuitant under subchapter II of this chapter commenced, or

"(2) if the annuity had previously been reduced to provide for a survivor annuity under section 8432 of this title, the date the previous reduction in such annuitant's annuity was terminated under section 8415(b) of this title,

plus interest computed as provided in section 8438(a) of this title.

"(d) Notwithstanding any other provision of this section, an election under this section may not be made for the purpose of providing a survivor annuity payable from the Fund to a spouse of an annuitant by remarriage if—

"(A) such spouse was married to the annuitant on the date that payment of an annuity to the annuitant under subchapter II of this chapter commenced; and

"(B) rights to survivor benefits for such spouse based on marriage to such annuitant were then waived under section 8416(b)(2) of this title.

"§ 8435. Survivor benefits for eligible former spouses: entitlement; amount

"(a) Subject to subsections (b) through (g) of this section, an eligible former spouse of a deceased participant or deceased former participant who dies entitled to an immediate or deferred annuity under section 8411 or 8412 of this title is entitled to a survivor annuity under this section if and to the extent that—

"(1) an election under section 8436 of this title,

"(2) any court decree dissolving or annulling the marriage of the participant or former participant and the eligible former spouse, or

"(3) any court order or court-approved property settlement agreement incident to such decree,

expressly provides for such survivor annuity.

"(b)(1) The amount of the survivor annuity payable from the Fund to an eligible former spouse of a deceased participant or deceased former participant under this section may not exceed the excess, if any, of—

"(A) the amount applicable in the case of such eligible former spouse, as determined under paragraph (2) of this subsection, over

"(B) the amount of all other survivor annuities payable from the Fund under this section to other eligible former spouses of the participant or former participant based on the order of precedence provided in subsection (d) of this section.

"(2) For the purposes of paragraph (1)(A) of this subsection, the amount applicable in the case of an eligible former spouse of a deceased participant or deceased former participant is the amount—

"(A) which is equal to 50 percent of the amount of the deceased former participant's annuity payable to the former participant on the day before the date of the former participant's death, if the deceased former participant was an annuitant on such day;

"(B) which would be applicable under paragraph (3) of section 8431(a) of this title in the case of a surviving spouse of the deceased, if the deceased was a participant described in paragraph (1) or (2) of such section 8431(a); or

"(C) which would be applicable under paragraph (2) of section 8431(b) of this title in the case of a surviving spouse of the deceased, if the deceased was a former participant described in paragraph (1) of such section 8431(b).

"(c) The total amount of all survivor annuities payable from the Thrift Savings Fund to eligible former spouses of a deceased participant or deceased former participant pursuant to this section may not exceed the amount of the survivor annuities that would be payable to the former spouses out of 100 percent of the balance in the account of the deceased participant or deceased former participant, plus anticipated net earnings from investments allocable to such account, determined on an actuarial basis in accordance with regulations prescribed by the Board.

"(d) If more than one eligible former spouse is entitled to a survivor annuity pursuant to this section, the amount of each such survivor annuity shall be limited appropriately to carry out subsection (b) or (c) of this section on a first-come, first-served basis determined by reference to the date an election is properly made pursuant to section 8436 of this title or the date the Director or Executive Director, as the case may be, properly receives a copy of the court decree, order, or court-approved agreement applicable to the entitlement.

"(e) The commencement and termination dates of a survivor annuity payable under this section to an eligible former spouse of a deceased participant or deceased former participant shall be the commencement and termination dates determined under the provisions of the applicable court order, decree, or agreement or an election, as the case may be (if provided in such order, decree, agreement, or election), except that any such survivor annuity—

"(1) shall not commence before—

"(A) the day after the participant or former participant dies, or

"(B) the first day of the second month beginning after the date on which the Office receives written notice of the court order, decree, or agreement or the election, as the case may be, together with such additional information or documentation as the Office may prescribe,

whichever is later, and

"(2) shall terminate not later than the date provided in section 8464(b)(2) of this title.

"(f) For the purposes of this section, a court decree, order, or agreement or an election referred to in subsection (a) of this section shall not be effective, in the case of a survivor annuity payable out of the Fund to a former spouse, to the extent that the election is inconsistent with any joint waiver previously executed with respect to such former spouse under section 8416(b)(2) of this title.

"(g) Any payment under this section to a person bars recovery by any other person.

"§ 8436. Survivor benefits for former spouses: elections, deposits and collections, and administrative provisions

"(a)(1) If an annuitant has an eligible former spouse on the date that the annuitant applies for payment of an annuity to the annuitant under subchapter II of this chapter to commence, the annuitant may elect, under procedures prescribed by the Office, to provide a survivor annuity for such former spouse under section 8435 of this title. An election under this paragraph shall be made on such date or, if later, within 2 years after the date on which the marriage of the former spouse to the annuitant was dissolved or annulled. The election shall specify the amount of the survivor annuity to be provided under this paragraph.

"(2) If an annuitant makes an election under paragraph (1) of this subsection to provide a survivor annuity payable out of the Fund and the annuitant makes the election during the 2-year period referred to in such paragraph, the annuitant shall deposit in the Fund, within such period, an amount determined by the Office, as nearly as may be administratively feasible, to reflect the amount by which the annuity of such an annuitant would have been reduced if the election had been continuously in effect since the date the annuity commenced, plus interest computed as provided in section 8438(a) of this title.

"(3) An election under paragraph (1) of this subsection—

"(A) shall not be effective to the extent that it conflicts with—

"(i) any court decree or order referred to in subsection (a) of section 8435 of this title, or "(ii) any agreement referred to in such subsection,

which is received by the Office before the date on which such election is made;

"(B) shall not be effective to the extent that the amount of the annuity specified in the election exceeds—

"(i) in the case of a survivor annuity payable from the Fund, the amount determined pursuant to subsections (b)(2) and (d) of section 8435 of this title; or

"(ii) in the case of a survivor annuity payable from the Thrift Savings Fund, the amount determined pursuant to subsections (c) and (d) of section 8435 of this title; and

"(C) shall not be effective, in the case of an annuitant who is married on the date of the election, unless the election is made with the written consent of the annuitant's spouse.

"(b) An annuitant who has elected to provide a survivor annuity for an eligible former spouse pursuant to subsection (a) of this section may make an election to provide or increase a survivor annuity for any other eligible former spouse of the annuitant within the same period that, and subject to the same conditions under which, an election could be made under subsection (c) of this section for a spouse of the annuitant (subject to the provisions of subsection (a)(3)(C) of this section relating to the consent of a spouse, if the annuitant is then married). The opportunity to make an election under the preceding sentence is in addition to any opportunity otherwise provided under this subsection.

"(c) If the entitlement of an eligible former spouse of an annuitant to a survivor annuity under this subchapter is terminated or reduced by reason of the remarriage or death of the former spouse, the annuitant may elect, in a signed writing received by the Office (in the case of a survivor annuity to be paid out of the Fund) or the Executive Director (in the case of a survivor annuity to be paid out of the Thrift Savings Fund) within 2 years after the former spouse's date of death or remarriage, as the case may be, to provide a survivor annuity under the method described in section 8416(a)(2)(B) of this title (in the case of a terminated or reduced entitlement payable out of the Fund) or in subparagraph (B) or (D) of section 8424(a)(2) of this title (in the case of a terminated or reduced entitlement payable from the Thrift Savings Fund).

"(d) The requirement that the spouse of an annuitant waive a right to a survivor annuity under this subchapter as a condition for an election authorized by subsection (a)(3)(C) of this section shall not apply if the participant or annuitant establishes to the satisfaction of the Office that—

"(1) the spouse's whereabouts cannot reasonably be determined; or

"(2) due to exceptional circumstances, it would be inappropriate to require the participant or annuitant to obtain the spouse's consent.

"§ 8437. Termination of entitlement

"(a) An election of an annuitant to provide a survivor annuity to the annuitant's spouse under this subchapter terminates on the first day of the first month beginning after—

"(1) the date of the death of the spouse; or

"(2) the date of the dissolution of the spouse's marriage to the annuitant.

"(b) The entitlement of an eligible former spouse of a former participant to a survivor annuity under section 8435(a) of this title terminates on the first day of the first month beginning after—

"(1) the date of the death of the former spouse; or

"(2) the date the former spouse remarries before becoming 55 years of age.

"§ 8438. Deposits to the Fund

"(a) For the purposes of section 8434(c) or 8436(a)(2) of this title, the annual rate of interest for each year during which an annuity would have been reduced if the election referred to in such section had been in effect on and after the applicable date referred to in such section shall be the percent determined for such year under section 8334(e) of this title.

"(b) If an annuitant does not make a deposit required by section 8434(c) or 8436(a)(2) of this title, the Office shall collect such amount by offset against the annuitant's annuity payable from the Fund, up to a maximum of 25 percent of the net annuity otherwise payable to the annuitant. The annuitant is deemed to consent to such offset.

"(c) The Office may extend the time limit for making a deposit required by section 8434(c) or 8436(a)(2) of this title in any case for good cause shown.

"SUBCHAPTER V—DISABILITY BENEFITS

"§ 8441. Definitions

"For the purposes of this subchapter—

"(1) the term 'administrator of benefits' means an insurance company or other entity which—

"(A) offers claims payment services and related administrative services under benefit plans provided by employers in the private sector; and

"(B) has entered into a contract with the Office pursuant to section 8450 of this title;

"(2) the term 'disability benefits under the Social Security Act' means disability insurance benefits payable under section 223 of the Social Security Act or benefits payable under section 202 of such Act by reason of being under a disability;

"(3) the term 'disability date', when used with respect to an eligible participant, means the date the eligible participant became disabled;

"(4) the term 'disabled', when used with respect to an eligible participant, means that the eligible participant—

"(A) is under a disability within the meaning of section 223 of the Social Security Act; or

"(B) is unable, because of disease or injury, to render useful and efficient service in the participant's position and is not qualified for reassignment, under procedures prescribed by the Office, to a vacant position—

"(i) which is in the participant's employing agency and is in the participant's commuting area;

"(ii) which is at the same grade or pay level as the participant's position; and

"(iii) in which the participant would be able to render useful and efficient service;

"(5) the term 'eligible participant' means an employee or Member whose service exceeds 18 months and—

"(A) who—

"(i) has applied for disability benefits under the Social Security Act and has been determined to be under a disability for the purposes of title II of the Social Security Act; or

"(ii) in the case of an employee or Member who is not entitled to disability benefits under the Social Security Act by reason of insufficient quarters of coverage, has been determined by an administrator of benefits to be disabled within the meaning of paragraph (4)(A) of this section on the basis of a report of examination required by section 8445 of this title; or

"(B) who has been determined by an administrator of benefits to be disabled within the meaning of paragraph (4)(B) of this section on the basis of a report of examination required by section 8445 of this title;

"(6) the term 'onset average pay', when used with respect to a disabled eligible participant, means the participant's average pay on the participant's disability date increased on January 1 of each year after such date by the same percent by which annuities referred to in paragraph (1) of section 8462(b) of this title are increased under such section 8462(b) in December of the preceding year, and compounded; and

"(7) the term 'projected service', when used with respect to a disabled eligible participant, means the sum of the number of years of service performed by the participant before the participant's disability date and the number of years, if any, after such date and before the date the participant becomes—

"(A) in the case of an eligible participant referred to in subparagraph (5)(A) of this section, 62 years of age; or

"(B) in the case of an eligible participant referred to in subparagraph (5)(B) of this section, 55 years of age.

"§ 8442. Entitlement

"(a)(1) A person who is an eligible participant, is disabled, and has used all sick leave accrued and accumulated under subchapter I of chapter 63 of this title or any other similar applicable provision of law relating to Government employment is entitled to receive disability benefits under this subchapter while—

"(A) in the case of a person who is disabled within the meaning of section 8441(4)(A) of this title, such person is under 62 years of age; and

"(B) in the case of a person who is disabled within the meaning of section 8441(4)(B) of this title, such person is under 55 years of age.

"(2) When a person referred to in paragraph (1) of this subsection exceeds the maximum age at which the person is qualified for benefits under such paragraph, the person shall be treated as an eligible participant for the purposes of entitlement to benefits under subsection (b) of this section.

"(b)(1) An eligible participant who—

"(A) is disabled within the meaning of section 8441(4)(A) of this title and is not less than 62 years of age, or

"(B) is disabled within the meaning of section 8441(4)(B) of this title and is not less than 55 years of age,

and who has 5 or more years of service and projected service shall be entitled to an annuity as provided in subchapter II of this title.

"(2) For the purposes of applying the provisions of subchapter II of this title in the case of an eligible participant pursuant to paragraph (1) of this subsection—

"(A) the eligible participant shall be deemed to have separated from Government employment on the day before the date the participant becomes entitled to an annuity pursuant to paragraph (1) of this subsection;

"(B) the service of the participant shall include the participant's projected service; and

"(C) the participant's average pay shall be equal to the participant's onset average pay.

"§ 8443. Computation of benefits

"(a) The annual rate of the disability benefits payable under section 8442(a) of this title to an eligible participant referred to in section 8441(5)(A) of this title shall be equal to the excess of 60 percent of the participant's onset average pay over the amount, if any, payable to the participant as disability benefits under the Social Security Act.

"(b) The annual rate of the disability benefits payable under section 8442(a) of this title to an eligible participant referred to in section 8441(5)(B) of this title—

"(1) during the period ending 1 year after the eligible participant's disability date, shall be equal to the excess of 60 percent of the participant's onset average pay over the amount, if any, payable to the participant as disability benefits under the Social Security Act; and

"(2) after such period, while the participant is under 55 years of age, shall be equal to the excess of 40 percent of the participant's onset average pay over the amount, if any, payable to the participant as disability benefits under the Social Security Act.

"§ 8444. Application

"(a) Except as provided in subsection (b) of this section, a claim of a participant for disability benefits under this subchapter may be allowed only if the participant files with the appropriate administrator of benefits an application for the disability benefits before the date the participant separates from Government employment or within 1 year after such date.

"(b) An appropriate administrator of benefits may waive the time limitation set out in subsection (a) of this section in the case of a participant if—

"(1) the administrator of benefits determines that the participant was mentally incompetent on the date the participant separated from Government employment or within 1 year after such date; and

"(2) the application for disability benefits is filed within 1 year after the date the participant is restored to mental competency or the date a fiduciary is appointed to manage the financial affairs of the participant, whichever date is earlier.

"§ 8445. Medical examinations

"(a) A participant applying for or receiving disability benefits under section 8442(a) of this title shall be examined by a physician under the direction of the appropriate administrator of benefits at such times as such administrator may require.

"(b) A physician examining a participant under subsection (a) of this section shall report to the appropriate administrator of benefits the diagnosis and prognosis with respect to such participant.

"(c) Notwithstanding any other provision of this subchapter, any participant who fails to submit to the examination required under subsection (a) of this section shall not be entitled to disability benefits.

"§ 8446. Offers of alternative employment

"(a)(1) Any participant who is applying for disability benefits under this subchapter, is examined pursuant to section 8445 of this title, and is determined on the basis of the examination to be able to perform the work required in any position described in paragraph (2) of this subsection shall be considered for appointment to such position.

"(2) A position referred to in paragraph (1) of this subsection is a position which is in the agency of the Government employing the participant referred to in such paragraph, is a position for which the participant is qualified, is not lower than the grade or pay level of the participant's position, and is within the participant's commuting area.

"(b) Any participant who is appointed to or offered a position under subsection (a) of this section is entitled to appeal to the Merit Systems Protection Board under section

7701 of this title any determination that the participant is able to perform the work required of such position.

"§ 8447. Recovery or restoration of earning capacity

"(a)(1) If an administrator of benefits determines that an individual who is receiving disability benefits under this subchapter has recovered from the disability before becoming 62 years of age (in the case of an individual who is disabled within the meaning of section 8441(4)(A) of this title) or 55 years of age (in the case of an individual who is disabled within the meaning of section 8441(4)(B) of this title), payment of the benefits shall terminate on the date the individual is reemployed by the Government or 1 year after the date of the medical examination on which such administrator's determination is based, whichever date is earlier.

"(2)(A) Payment of disability benefits to any individual under this chapter that has been terminated pursuant to paragraph (1) of this subsection shall be resumed if there is a recurrence of the individual's disability, as determined by an administrator of benefits after a medical examination of the individual, and the individual is under 62 years of age (in the case of an individual who is disabled within the meaning of section 8441(4)(A) of this title) or under 55 years of age (in the case of an individual who is disabled within the meaning of section 8441(4)(B) of this title).

"(B) A resumption of payment of disability benefits under subparagraph (A) of this paragraph shall be effective on the date the medical examination referred to in such paragraph was completed.

"(C) The annual rate of the disability benefits payable to an individual upon resumption of payment under subparagraph (A) of this paragraph shall be the annual rate that would have been payable to the individual if payment of disability benefits had not been terminated pursuant to paragraph (1) of this subsection.

"(b)(1) If the administrator of benefits determines that an individual who is receiving disability benefits under this subchapter has received, during the latest calendar year, income from wages or self-employment or both totaling the amount equal to 60 percent of the rate of pay payable for the individual's position of Government employment on the individual's disability date determined for the purposes of this subchapter (increased as if such rate of pay had been increased, by the same percent as the overall percent increase in the rates of pay under the General Schedule, each time such rates had been increased pursuant to section 5305 of this title since such date), payment of the benefits shall terminate on the date 60 days after the end of such calendar year.

"(2)(A) If payment of disability benefits under this subchapter has been terminated pursuant to paragraph (1) of this subsection in the case of an individual who is not reemployed in a position subject to this chapter, who continues to be disabled, who is under 62 years of age (in the case of an individual who is disabled within the meaning of section 8441(4)(A) of this title) or under 55 years of age (in the case of an individual who is disabled within the meaning of section 8441(4)(B) of this title), and who receives in the calendar year in which the disability benefits were terminated, or any calendar year after such year, income from wages or self-employment or both totaling less than the amount computed in such case as provided in such paragraph, payment of disability benefits to the individual under this subchapter shall be resumed.

"(B) A resumption of payment of disability benefits to an individual under subparagraph (A) of this paragraph shall be effective the first day of the first year beginning after the year in which the individual received the income referred to in such subparagraph.

"(C) The annual rate of the disability benefits payable to an individual upon resumption of payment of disability benefits under subparagraph (A) of this paragraph shall be the annual rate that would have been payable to the individual if payment had not been terminated pursuant to paragraph (1) of this subsection.

"(c) Any determination under this section may be appealed to the Office. A determination of the Office in such an appeal may be appealed to the Merit Systems Protection Board under section 7701 of this title. The Merit Systems Protection Board may hear and adjudicate any such appeal.

"§ 8448. Relationship to workers' compensation

"(a)(1) An individual is not entitled to receive disability benefits under this subchapter and compensation for injury to or disability of the individual under subchapter I of chapter 81 of this title covering the same period of time.

"(2) Paragraph (1) of this subsection does not bar the right of a claimant to the greater benefit conferred by either subchapter referred to in such paragraph for any part of the period referred to in such paragraph.

"(3) Paragraph (1) of this subsection and the provisions of subchapter I of chapter 81 of this title do not deny an individual an annuity which the individual is entitled to receive under this chapter on account of service performed by the individual and do not deny any concurrent benefit to the individual under subchapter I of chapter 81 of this title on account of the death of another individual.

"(b)(1) Subject to paragraph (2) of this subsection, an individual's receipt of a lump-sum payment for compensation under section 8135 of this title shall not affect the individual's entitlement to disability benefits under this subchapter.

"(2) If disability benefits are payable under this subchapter by reason of the same disability for which a lump-sum payment of compensation referred to in paragraph (1) of this subsection has been made, so much of the compensation as has been paid for a period extended beyond the date payment of the disability benefits commences, as determined by the Department of Labor, shall be refunded to that Department for credit to the Employees' Compensation Fund. Before the individual may receive the disability benefits, the individual shall—

"(A) refund to the Department of Labor the amount representing the commuted compensation payments for the extended period; or

"(B) authorize the deduction of the amount from the disability benefits.

Deductions from the disability benefits may be made from accrued or accruing payments. The amounts deducted and withheld from disability benefits shall be transmitted to the Department of Labor for reimbursement to the Employees' Compensation Fund. When the Department of Labor finds that the financial circumstances of an individual entitled to disability benefits under this subchapter warrant deferred refunding under this paragraph, deductions from the disability benefits may be prorated against and paid from accruing payments in such manner as the Department determines appropriate.

"§ 8449. Military reserve technicians

"(a)(1) Except as provided in paragraph (2) of this subsection, a participant shall be entitled to disability benefits under this subchapter in the same manner as an eligible participant described in section 8441(5)(B) of this title if the participant—

"(A) is separated from employment as a military reserve technician by reason of a disability that disqualifies the individual from membership in a reserve component of the Armed Forces specified in section 261(a) of title 10 or from holding the military grade required for such employment:

"(B) is not considered disabled;

"(C) is not appointed to another position in the Government (under subsection (b) of this section or otherwise); and

"(D) has not declined an offer of appointment to a position in the Government under subsection (b) of this section.

"(2) Payment of disability benefits to an individual under this section terminates—

"(A) on the date the individual is appointed to a position in the Government (under subsection (b) of this section or otherwise);

"(B) on the date the individual declines an offer of appointment to a position in the Government pursuant to subsection (b) of this section; or

"(C) as provided in section 8447(a) or 8447(b) of this title.

"(b) Any individual applying for or receiving disability benefits pursuant to this section shall, in accordance with regulations prescribed by the Office, be considered by any agency of the Government before any vacant position in the agency is filled if—

"(1) the position is located within the commuting area of the individual's former position;

"(2) the individual is qualified to serve in the vacant position; and

"(3) the position is at the same grade or equivalent level as the position from which the individual was separated.

"§ 8450. Administrative provisions

"(a) For the purpose of this section, the term 'State' means a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and a territory or possession of the United States.

"(b) The Office shall enter into a contract with one or more insurance companies or other entities described in section 8441(1)(A) of this title to provide long-term group disability insurance benefits under this subchapter and to administer the provisions of this subchapter which the Office is not specifically required by this chapter to administer. Each such company or other entity shall meet the following requirements:

"(1) It must be licensed to transact insurance under the laws of a State.

"(2) It must have in effect, on the most recent December 31 for which information is available to the Office, an amount of employee group disability insurance equal to at least 1 percent of the total amount of employee group disability insurance in the United States in all insurance companies.

"(c) A contractor under a contract awarded under subsection (b) of this section shall establish an administrative office under a name approved by the Office.

"(d) Each contract awarded by the Office under subsection (b) of this section may remain in effect for a period not exceeding 5 years and may include a provision authorizing extension of the contract, with the consent of the contractor, for successive periods of 1 year each.

"(e) The Director may include in contracts awarded under subsection (b) of this section such terms and conditions as he considers appropriate to protect the interests of participants and the United States.

"(f) All records established or maintained by an administrator of benefits in the administration of this subchapter shall be the property of the United States. The administrator of benefits shall deliver such records to the Office whenever requested by the Office.

"(g) The provisions of any contract under this subchapter which relate to the nature or extent of coverage or benefits (including payments with respect to benefits) shall supersede and preempt any law of any State or political subdivision thereof, or any regulation issued thereunder, which relates to group disability insurance to the extent that the law or regulation is inconsistent with the contractual provisions.

"(h) The Secretary of Health and Human Services shall furnish to the Office and an administrator of benefits such information, including information on individuals claiming entitlement to benefits under this subchapter, as the Office determines to be necessary to carry out this subchapter.

"§ 8451. Annual accounting; special contingency reserve

"A contract awarded under section 8450 of this title shall include a provision requiring the administrator of benefits under the contract to transmit an accounting to the Office not later than 90 days after the end of each policy year. The accounting shall set forth, in a form approved by the Office—

"(1) the total of all claim charges incurred for the contract year; and

"(2) the amounts of the expenses of the administrator of benefits charged for the contract year.

"§ 8452. Federal Employees' Disability Insurance Fund

"(a) There is established in the Treasury of the United States a fund to be known as the 'Federal Employees' Disability Insurance Fund'.

"(b)(1) Each agency of the Government employing participants shall make periodic payments to the Federal Employees' Disability Insurance Fund in the amount of the portion of the premium payable for the applicable period (as determined by the Office) which is attributable to such participants, as determined by the Office and the appropriate administrator of benefits.

"(2) An employing agency shall pay the amounts required by paragraph (1) of this subsection from the appropriation or fund available for payment of the basic pay or salaries of employees of the agency. In the case of a participant in the legislative branch who is paid by the Clerk of the House of Representatives, the amount shall be paid from the contingent fund of the House of Representatives.

"(c) Sums in the Federal Employees' Disability Insurance Fund shall be available without fiscal year limitation for the payment of premiums for long-term group disability insurance under this subchapter.

"(d) The Secretary of the Treasury may invest and reinvest any of the money in the Federal Employees' Disability Insurance Fund in interest-bearing obligations of the United States and may sell such obligations for the purposes of such fund. The interest on and the proceeds from the sale of these obligations, and the income derived from premium rate adjustments, become a part of such fund.

"(e)(1) No tax, fee, or other monetary payment may be imposed or collected by any State or by any political subdivision or other governmental authority thereof on or with respect to any premium paid for long-term group disability insurance under this subchapter.

"(2) Paragraph (1) of this subsection shall not be construed to exempt any administrator of benefits from the imposition, payment, or collection of a tax, fee, or other monetary payment on the net income or profit accruing to or realized by the administrator from business conducted under this subchapter, if that tax, fee, or payment is applicable to a broad range of business activity.

"SUBCHAPTER VI—GENERAL AND ADMINISTRATIVE PROVISIONS

"§ 8461. Authority of the Office of Personnel Management

"(a) The Office shall pay all benefits that are payable under subchapter II of this chapter from the Fund.

"(b) The Office shall administer all provisions of this chapter not specifically required to be administered by the Board, the Executive Director, or any other agency.

"(c) The Office may make regulations to carry out the provisions of this chapter administered by the Office.

"(d) The Office may contract for the performance of any administrative services necessary to carry out its responsibilities under this chapter.

"§ 8462. Cost-of-living adjustment in basic plan annuities and survivor annuities

"(a) For the purpose of this section—

"(1) the term 'base quarter', when used with respect to a year, means the calendar quarter ending on September 30, of such year; and

"(2) the price index for a base quarter is the arithmetic mean of such index for the 3 months comprising such quarter.

"(b)(1) Except as provided in subsection (c) of this section, effective December 1 of each year in which the price index for the base quarter of such year exceeds the price index for the base quarter of the preceding year, each annuity which is payable from the Fund under subchapter II or IV of this chapter and commences not later than such December 1 shall be increased by the percentage computed under paragraph (2) of this subsection.

"(2) The percentage by which an annuity is increased under paragraph (1) of this subsection in any year shall be the excess, if any, of—

"(A) the percentage of the increase in the price index for the base quarter of such year over the price index of the preceding year, over

"(B) 2 percent.

"(c)(1) The first increase (if any) made under subsection (b) of this section to an annuity payable to a participant who retires, to the surviving spouse or surviving former spouse of a deceased participant, or to the surviving spouse or surviving former spouse of a deceased annuitant whose annuity has never been increased under this subsection or subsection (b) of this section shall be equal to the product (adjusted to the nearest one-tenth of 1 percent) of—

"(A) one-twelfth of the applicable percentage of the adjustment computed under subsection (b) of this section, multiplied by

"(B)(i) the number of months (counting any portion of a month as a month) for which the annuity was payable before the effective date of the increase, or

"(ii) in the case of a survivor annuity payable to a surviving spouse or surviving former spouse of a deceased annuitant whose annuity has never been so increased, the number of months (counting any portion of a month as a month) since the annuity was first payable to the deceased annuitant.

"(2) Effective on its commencing date, an annuity referred to in subsection (b) of this section and payable to an annuitant's surviving spouse or surviving former spouse shall be increased by the total percentage by which the deceased annuitant's annuity had been increased under this section during the period beginning on the date the deceased annuitant's annuity commenced and ending on the date of the deceased annuitant's death.

"(d) The monthly installment of an annuity payable after adjustment under this section shall be rounded to the next lowest dollar, but the increase in the monthly installment under this section shall be at least $1.

"§ 8463. Rate of benefits

"Each annuity and disability benefit is stated as an annual amount, one-twelfth of which, fixed at the next lowest dollar, constitutes the monthly rate payable on the first business day of the first month beginning after the last day of the month for which the annuity or disability benefit has accrued.

"§ 8464. Commencement and termination of annuities

"(a)(1) Except as otherwise provided in this chapter, the annuity of a participant under subchapter II of this chapter shall commence on the first day of the first month beginning after—

"(A) the date the participant separates from Government employment entitled to an immediate annuity under section 8411 of this title, or

"(B) in the case of a participant who is entitled to a deferred annuity under section 8412 of this title and is not entitled to an immediate annuity under section 8411 of this title, the date elected by the participant under section 8412(a) of this title or the date the participant becomes 62 years of age, whichever is earlier, as the case may be.

"(2) The annuity of an annuitant under this chapter terminates on the date of death or other terminating event provided by law.

"(b)(1) Except as otherwise provided in this chapter, a survivor annuity payable to an individual under this chapter shall commence on the first day of the first month beginning after the date of the death of the deceased participant or former participant on whose death such annuity is based.

"(2) A survivor annuity payable to a surviving spouse or an eligible former spouse of a deceased participant or deceased former participant under this chapter terminates on the last day of the last month ending before the surviving spouse or former spouse dies or, if the surviving spouse or former spouse is less than 55 years of age, remarries.

"§ 8465. Waiver, allotment, and assignment of benefits

"(a) An individual entitled to receive payment of benefits under subchapter II of this chapter may decline to accept all or any part of the amount of the benefits by a waiver signed and filed with the Office. The waiver may be revoked in writing at any time. Payment of the benefits waived may not be made for the period during which the waiver is in effect.

"(b) An individual entitled to receive payment of benefits under subchapter II of this chapter may make allotments or assignments of amounts from the benefits for such purposes as the Office considers appropriate.

"§ 8466. Application for benefits

"(a) No payment of benefits based on the service of a former participant shall be made under this chapter unless an application for payment of the benefits is received by the Office before the one hundred and fifteenth anniversary of the former participant's birth.

"(b) Notwithstanding subsection (a) of this section, after the death of a participant or former participant, a benefit based on the participant's or former participant's service shall not be paid under subchapter IV of this chapter unless an application therefor is received by the Office within 30 years after the death or other event which establishes the entitlement to the benefit.

"§ 8467. Court orders

"(a) Payments under this chapter which would otherwise be made to a participant or former participant based upon the service of the participant or former participant shall be paid (in whole or in part) by the Office or the Executive Director, as the case may be, to another person if and to the extent that the terms of any court decree of divorce, annulment, or legal separation, or the terms of any court order or court-approved property settlement agreement incident to any court decree of divorce, annulment, or legal separation expressly provide. Any payment under this paragraph to a person bars recovery by any other person.

"(b) Subsection (a) of this section shall apply only to payments made by the Office or the Executive Director under this chapter after the date on which the Office or the Executive Director, as the case may be, receives written notice of such decree, order, or agreement, and such additional information and documentation as the Office or the Executive Director may require.

"§ 8468. Annuities and pay on reemployment

"(a) If an annuitant becomes employed in an appointive or elective position in the Government, payment of any annuity under subchapter II of this chapter to the annuitant terminates effective on the date of the employment, and the annuitant's service on and after the date the annuitant becomes so employed is covered by this chapter. Upon termination of the employment, the rights of the annuitant under subchapter II of this chapter shall be redetermined. If the annuitant dies while still so employed, a survivor annuity payable with respect to the deceased annuitant shall be redetermined as if the employment had otherwise terminated on the date of death.

"(b) The amount of an annuity resulting from a redetermination of rights under this chapter pursuant to subsection (a) of this section shall not be less than the amount of the terminated annuity plus any increases under section 8462 of this title occurring after the termination of the annuity and before the commencement of the redetermined annuity.

"SUBCHAPTER VII—TRANSITION PROVISIONS

"§ 8471. Treatment of certain individuals subject to the Civil Service Retirement and Disability System

"(a)(1)(A) Any individual who is subject to subchapter III of chapter 83 of this title as an employee (as defined in section 8331(1) of this title, other than an individual employed by the government of the District of Columbia) or a Member (as defined in section 8331(2) of this title), whose service is not employment for the purposes of title II of the Social Security Act and chapter 21 of the Internal Revenue Code of 1954, and who is not required by section 8402 of this title to be a participant may elect to commence participation in the System.

"(B) An election made under subparagraph (A) of this paragraph shall be made in writing, in accordance with such regulations as the Office may prescribe, and not later than December 31, 1987, or, in the case of an individual who becomes an employee or Member after a break in service for a period that includes January 1, 1987, not later than 1 year after the date on which the individual resumes service.

"(2) Except as provided in section 8472(d) of this title, any individual who makes the election authorized by paragraph (1) of this subsection shall retain accrued credit for entitlement to benefits under subchapter III of chapter 83 of title 5, United States Code, for service performed while subject to such subchapter.

"(3) An individual referred to in paragraph (1) of this subsection who becomes an employee or Member after a break in service for a period that includes January 1, 1987, may make deposits under section 8334 of this title for service performed before such date while subject to subchapter III of chapter 83 of this title.

"(b) Except as provided in section 8472(d) of this title, any individual who—

"(1) has an unrefunded lump-sum credit in the Fund under subchapter III of chapter 83 of this title,

"(2) is required by section 8402 of this title to be a participant, and

"(3) is not a participant referred to in section 8473(a) of this title,

shall retain accrued credit for entitlement to benefits under such subchapter for service performed while subject to such subchapter.

"(c) Except as provided in section 8472(d) of this title, any individual who—

"(1) has received a refund of a lump-sum credit in the Fund under subchapter III of chapter 83 of this title, "(2) is required by section 8402 of this title to be a participant, and

"(3) is not a participant referred to in section 8473(a) of this title,

may make deposits under section 8334 of this title for service performed before January 1, 1987, while subject to subchapter III of chapter 83 of this title and shall, upon making such deposits, be entitled to credit under such subchapter for service covered by the deposits.

"(d) Survivor benefits shall be payable as provided in subchapter III of chapter 83 of this title and this chapter to the extent of the service creditable under such subchapter (pursuant to this section) and this chapter in the case of a participant referred to in subsection (a), (b), or (c) of this section.

"§ 8472. Special rules for participants retaining entitlement in the Civil Service Retirement and Disability System

"(a) Service that is creditable under subchapter III of chapter 83 of this title in the case of an individual who retains entitlement in the Civil Service Retirement and Disability System under section 8471 of this title shall be credited as service under this chapter only—

"(1) for the purposes of determining eligibility to retire entitled to an annuity under section 8411 or

8412 of this title and entitlement for disability benefits under subchapter V of this chapter; and

"(2) for the purpose of considering such service as years of participation in the System for the purposes of section 8422 of this title (relating to vesting under the thrift savings plan).

"(b) Service performed as a participant in the System by an individual referred to in subsection (a) of this section shall be credited under subchapter III of chapter 83 of this title only for the purpose of determining eligibility to retire entitled to an annuity under section 8335, 8336, or 8338 of this title.

"(c)(1) The rates of basic pay in effect for an individual referred to in subsection (a) of this section on and after the date the individual begins to participate in the System shall be taken into account in computing the individual's average pay (as defined in section 8331(4) of this title) for the purposes of subchapter III of chapter 83 of this title.

"(2) The rates of basic pay in effect for an individual referred to in subsection (a) of this section before the date the individual begins to participate in the System shall be taken into account in computing the individual's average pay for the purposes of this chapter.

"(d) Section 8337 of this title (relating to disability retirement) shall not apply in the case of a participant referred to in subsection (a).

"§ 8473. Participants subject to the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983

"(a)(1) The service of a participant with respect to which a reduced contribution is made under section 204(a) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 (97 Stat. 1107; 5 U.S.C. 8331 note) shall be credited as service for the purposes of this chapter and shall be considered years of participation in the System for the purposes of section 8422(b)(1) of this title.

"(2) Paragraph (1) of this subsection shall not apply to an individual who serves continuously as a Member of Congress during the period beginning December 31, 1983, and ending January 1, 1987.

"(b)(1) On January 1, 1987, the amount computed under paragraph (2) of this subsection shall be transferred from the Fund to the Thrift Savings Fund in the case of a participant to whom subsection (a)(1) of this section applies. The amount transferred shall be credited to an account established for the individual pursuant to section 8428(a) of this title.

"(2)(A) The amount transferred from the Fund in the case of a participant pursuant to paragraph (1) of this subsection shall be equal to the sum of—

"(i) two times the total amount deducted and withheld from the basic pay of the participant pursuant to section 204(a) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 (97 Stat. 1107; 5 U.S.C. 8331 note); and

"(ii) interest on the amount referred to in clause (i) of this subparagraph computed at the annual rate determined under the second sentence of this subparagraph and compounded annually, as if a fraction of such amount (determined as provided in subparagraph (B) of this paragraph) had been deposited to the credit of the Fund at the end of each month for which amounts were deducted and withheld from the basic pay of the participant as described in clause (i) of this subparagraph.

The annual rate referred to in clause (ii) for an amount transferred from the Fund in any calendar year shall be equal to the interest rate determined for such calendar year under section 8334(e) of this title.

"(B) In the case of any participant to whom paragraph (1) of this subsection applies—

"(i) the numerator of the fraction referred to in subparagraph (A)(ii) of this paragraph is one; and

"(ii) the denominator of the fraction is the number of months for which amounts were deducted and withheld from the basic pay of the participant as described in subparagraph (A)(i) of this paragraph.

"(3) For the purposes of section 8422 of this title—

"(A) one-half of the amount computed in the case of a participant referred to in subsection (a) of this section pursuant to paragraph (2) of this subsection shall be treated as a contribution made under section 8421(a) of this title; and

"(B) one-half of such amount shall be treated as a contribution made by the employing agency of the participant pursuant to section 8421(b) of this title.

"(4) All amounts transferred from the Fund pursuant to paragraph (1) of this subsection shall be transferred in the form of interest-bearing securities of the United States.

"(c) The total amount of any deposit made to the Fund under section 8334(j) of this title (relating to deposits covering periods of military service) in the case of a participant referred to in paragraph (1) of this subsection shall be refunded to the participant. The refund shall be paid out of sums in the Fund.

"§ 8474. Reemployed annuitants under a Government retirement system.

"(a) For the purposes of this section—

"(1) the term 'annuitant'—

"(A) in the case of the Civil Service Retirement and Disability System, shall have the same meaning provided in section 8331(9) of this title;

"(B) in the case of the Foreign Service Retirement and Disability System, shall have the same meaning provided in section 804(1) of the Foreign Service Act of 1980 (22 U.S.C. 4044(1)), except that such term does not include a survivor; and

"(C) in the case of the Central Intelligence Agency Retirement and Disability System, means—

"(i) any participant who is referred to in section 203 of the Central Intelligence Agency Retirement Act of 1964 for Certain Employees, and

"(ii) any individual who formerly was such a participant,

entitled to an annuity from the Central Intelligence Agency Retirement and Disability Fund;

"(2) the term 'Government retirement system' means—

"(A) the Civil Service Retirement and Disability System under subchapter III of chapter 83 of this title;

"(B) the Foreign Service Retirement and Disability System under chapter 8 of the Foreign Service Act of 1980 (22 U.S.C. 4041 et seq.); and

"(C) the Central Intelligence Agency Retirement and Disability System under the Central Intelligence Agency Retirement Act of 1964 for Certain Employees (50 U.S.C. 403 note); and

"(3) the term 'reemployed annuitant' means an annuitant who becomes employed by the Government after the effective date of the Civil Service Pension Reform Act of 1985 and is required by section 8402 of this title to be a participant.

"(b) A reemployed annuitant shall retain entitlement in the Government retirement system under which the annuitant is receiving an annuity.

"(c)(1) Service that is creditable under the Government retirement system of a reemployed annuitant shall be credited under this chapter only for the purpose of determining eligibility to retire entitled to an annuity under section 8411 of this title.

"(2) Service performed as a reemployed annuitant shall not be creditable service for the purposes of the Government retirement system of the reemployed annuitant.

"(d)(1) The rates of basic pay in effect for a reemployed annuitant on and after the date the annuitant begins to participate in the System shall be taken into account in computing the annuitant's average pay for the purposes of the Government retirement system under which the annuitant was receiving an annuity when the reemployment commenced.

"(2) The rates of basic pay in effect for a reemployed annuitant before the date the annuitant begins to participate in the System shall be taken into account in computing the annuitant's average pay for the purposes of this chapter.

"(e) Deductions may not be withheld from the pay of a reemployed annuitant for the purposes of the reemployed annuitant's Government retirement system while the reemployed annuitant is a participant in the System.

"§ 8475. Exemption from certain offset provisions of the Social Security Act

"Sections 202(b)(4), 202(c)(2), 202(e)(7), 202(f)(2), 202(g)(4), and 215(a)(7) of the Social Security Act shall not apply in the case of a person who is a participant referred to in section 8471 of this title.

"§ 8476. Regulations

"The Office may prescribe regulations to carry out this subchapter.

"SUBCHAPTER VIII—CIVIL SERVICE THRIFT INVESTMENT MANAGEMENT SYSTEM

"§ 8491. Civil Service Thrift Investment Board

"(a) There is established in the executive branch of the Government a Civil Service Thrift Investment Board.

"(b)(1) The Board shall be composed of—

"(A) the Chairman of the Federal Reserve Board;

"(B) the Secretary of the Treasury;

"(C) the Director; and

"(D) two representatives of Federal employee organizations appointed by the President, one of whom shall be a representative from a labor organization (as defined in section 7103(a)(4) of this title) and one of whom shall be a representative from an organization for employees who are managers.

"(2) If an office referred to in paragraph (1)(A), (1)(B), or (1)(C) of this subsection is vacant, the person acting as the officer in such office shall be a member of the Board while acting as such officer.

"(3) The Chairman of the Federal Reserve Board shall be the Chairman of the Board.

"(4) The members of the Board appointed under paragraph (1)(D) of this subsection shall serve until replaced by the President.

"(c) The Board shall—

"(1) establish policies and prescribe regulations for—

"(A) the investment and management of the Thrift Savings Fund; and

"(B) the administration of subchapter III of this chapter and the provisions of subchapter IV of this chapter which relate to survivor annuities payable out of the Thrift Savings Fund;

"(2) review the performance of investments made for the Thrift Savings Fund;

"(3) without regard to civil service and classification laws, fix the rate of pay of the Executive Director;

"(4) supervise the Executive Director; and

"(5) review and approve the budget of the Board.

"(d)(1) The Board may—

"(A) adopt, alter, and use a seal;

"(B) adopt, amend, and repeal regulations to carry out its functions;

"(C) disapprove any action of the Executive Director;

"(D) except as provided in paragraph (2) of this subsection, direct the Executive Director to take such action as the Board considers appropriate to carry out the provisions of this subchapter and subchapter III of this chapter, the provisions of subchapter IV of this chapter which relate to survivor annuities payable out of the Thrift Savings Fund, and the policies of the Board;

"(E) upon the concurring votes of four members, remove the Executive Director from office for good cause shown; and

"(F) take such other action as may be necessary to carry out the functions of the Board.

"(2) Except in the case of investments required by section 8427 of this title to be invested in securities of the Government, the Board may not direct the Executive Director or any contractor under a contract awarded under section 8493(c)(2) this title to invest or to cause to be invested any sums in the Thrift Savings Fund in a specific asset or to dispose of or cause to be disposed any specific asset of such Fund.

"§ 8492. Civil Service Thrift Advisory Committee

"(a)(1) The Board shall establish a Civil Service Thrift Advisory Committee (hereafter in this subchapter referred to as the 'Advisory Committee').

"(2)(A) The Advisory Committee shall be composed of 6 members appointed as provided in subparagraph (B) of this paragraph.

"(B) The members of the Advisory Committee shall be appointed by action agreed to by a majority of the members of the Board. Three of the members of the Advisory Committee shall be appointed from among investment asset managers not employed by the Government and three of the members of the Advisory Committee shall be appointed from among administrators of thrift savings plans established for employees of private sector enterprises.

"(3) The Board shall prescribe the terms and conditions of service of the members of the Advisory Committee.

"(b) The Advisory Committee shall—

"(1) advise the Board and the Executive Director on matters relating to—

"(A)(i) investment policy for the Thrift Savings Fund;

"(ii) selection of the types of investment funds which are appropriate for investment of sums in the Thrift Savings Fund; and

"(iii) selection of investment managers for the purpose of contracting for the administration of investment funds under section 8493(c)(2) of this title; and

"(B)(i) the performance of the duties of the Board and the Executive Director under the provisions of this subchapter and subchapter III of this chapter and the provisions of subchapter IV of this chapter which relate to survivor annuities payable out of the Thrift Savings Fund; and

"(ii) the administration of such provisions; and

"(2) review the performance of investments made for the Thrift Savings Fund.

"§ 8493. Executive Director

"(a)(1) The Board shall appoint an Executive Director by action agreed to by a majority of the members of the Board. The Executive Director shall have substantial experience, training, or expertise in the management of financial investments.

"(2) The Board shall prescribe the terms and conditions of service of the Executive Director.

"(b) The Executive Director shall—

"(1) carry out the policies established by the Board;

"(2) invest and manage the Thrift Savings Fund in accordance with the investment and other policies established by the Board;

"(3) provide for payment of annuities and other authorized distributions from the Thrift Savings Fund under this chapter; and

"(4) administer the provisions of this subchapter, subchapter III of this chapter, the provisions of subchapter IV of this chapter which relate to survivor annuities payable out of the Thrift Savings Fund, and the regulations prescribed by the Board.

"(c) The Executive Director, may—

"(1) without regard to civil service and classification laws, appoint, employ, and fix the compensation of such personnel as may be necessary to carry out the provisions of this subchapter and subchapter III of this chapter and the provisions of subchapter IV of this chapter which relate to survivor annuities payable out of the Thrift Savings Fund;

"(2) enter into such contracts or other arrangements (including contracts for the performance of administrative services), and make such modifications thereof, as may be appropriate to carry out the provisions of this subchapter and section 8427 of this title and the policies of the Board;

"(3) except as provided in section 552a of this title, obtain from any Federal agency, including any independent establishment or instrumentality of the

United States, advice, information, estimates, statistics, and such other assistance as the Executive Director considers necessary to carry out the provisions of this subchapter and subchapter III of this chapter, the provisions of subchapter IV of this chapter which relate to survivor annuities payable out of the Thrift Savings Fund, and the policies of the Board;

"(4) make such payments out of sums in the Thrift Savings Fund as the Executive Director determines are necessary to carry out the provisions of this subchapter, subchapter III of this chapter, the provisions of subchapter IV of this chapter which relate to survivor annuities payable out of the Thrift Savings Fund, and the policies of the Board;

"(5) pay the compensation, per diem, and travel expenses of personnel from the Thrift Savings Fund;

"(6) accept and utilize the services of individuals employed intermittently in the Government service and reimburse such individuals for travel expenses, as authorized by section 5703 of this title, including per diem as authorized by section 5702 of this title;

"(7) except as otherwise expressly prohibited by law or the policies of the Board, delegate any of the Executive Director's functions to such officers and employees under the Board as the Executive Director may designate and authorize such successive redelegations of such functions to such officers and employees under the Board as the Executive Director may consider to be necessary or appropriate; and

"(8) take such other actions as are appropriate to carry out the functions of the Executive Director.

"§ 8494. Investment policy

"The Board shall develop investment policies under section 8491(c)(1) of this title which provide for—

"(1) prudent investments suitable for accumulating funds for payment of retirement income;

"(2) investment strategies which do not require a significant level of active investment decisionmaking in the case of the investment funds established under subparagraphs (B) and (C) of section 8427(b)(1) of this title;

"(3) low administrative costs; and

"(4) investments likely to receive broad acceptance by participants and the public.

"§ 8495. Administrative provisions

"(a) The Board shall meet—

"(1) not less than once during each fiscal year; and

"(2) at additional times at the call of the Chairman.

"(b)(1) Except as provided in section 8491(d)(1)(E) of this title, the Board shall perform the functions and exercise the powers of the Board on a majority vote of a quorum of the Board.

"(2) A vacancy on the Board shall not impair the authority of a quorum of the Board to perform the functions and exercise the powers of the Board.

"(c) Three members of the Board shall constitute a quorum for the transaction of business.

"(d)(1) Each member of the Board who is not a Federal employee and each member of the Advisory Committee shall be compensated at the daily rate of basic pay payable for grade GS-18 under the General Schedule for each day or part thereof during which such member is engaged in performing a function of the Board or Advisory Committee, as the case may be.

"(2) Each member of the Board who is not a Federal employee and each member of the Advisory Committee shall be paid travel, per diem, and other necessary expenses under subchapter I of chapter 57 of this title while traveling away from his home or regular place of business in the performance of the duties of the Commission or Advisory Board, as the case may be.

"(e) The accrued annual leave of any employee who is a member of the Board shall not be charged for any time used in performing service for the Board during any work period.

"(f) Section 14(a)(2) of the Federal Advisory Committee Act (86 Stat. 776; 5 U.S.C. App.) shall not apply to the Advisory Committee.

"§ 8496. Fiduciary responsibilities; liability and penalty

"(a) For the purposes of this section—

"(1) the term 'fiduciary' means—

"(A) with respect to the Thrift Savings Fund, each member of the Board and the Executive Director; and

"(B) any person who, with respect to the Thrift Savings Fund, is described in section 3(21)(A) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(21)(A));

"(2) the term 'party in interest' includes—

"(A) any fiduciary;

"(B) any counsel to a fiduciary;

"(C) any person providing services to the Board or the Executive Director;

"(D) a labor organization the members of which are participants;

"(E) a spouse, ancestor, lineal descendant, or spouse of a lineal descendant of a person described in subclause (A), (B), or (C) of this clause; and

"(F) a corporation, partnership, or trust or estate of which, or in which, 50 percent or more of—

"(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation;

"(ii) the capital interest or profits interest of such partnership; or

"(iii) the beneficial interest of such trust or estate,

is owned directly or indirectly, or held by a person described in subclause (A), (B), (C), or (E) of this clause; and

"(3) the term 'person' means an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or labor organization.

"(b)(1) A fiduciary shall discharge his responsibilities with respect to the Thrift Savings Fund or applicable portion thereof solely in the interest of the participants and beneficiaries and—

"(A) for the exclusive purpose of—

"(i) providing benefits to participants and their beneficiaries; and

"(ii) defraying reasonable expenses of administering the Thrift Savings Fund or applicable portions thereof;

"(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent individual acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like objectives; and

"(C) to the extent permitted by section 8427 of this title, by diversifying the investments of the Thrift Savings Fund or applicable portions thereof so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.

"(2) No fiduciary may maintain the indicia of ownership of any assets of the Thrift Savings Fund outside the jurisdiction of the district courts of the United States.

"(c) A fiduciary shall not—

"(1) deal with any assets of the Thrift Savings Fund for his own account;

"(2) act, in his individual or any other capacity, in any transaction involving the Thrift Savings Fund on behalf of a party whose interests are adverse to the interests of the Thrift Savings Fund or the interests of its participants or beneficiaries;

"(3) receive any consideration for his own personal account from any party dealing with sums credited to the Thrift Savings Fund in connection with a transaction involving assets of the Thrift Savings Fund, except fees which the fiduciary is entitled to receive as provided in a contract awarded under section 8493(c)(2) of this title;

"(4) permit the transfer of any assets of the Thrift Savings Fund to or the use of such assets by any person known to be a party in interest, except in return for adequate consideration; or

"(5) permit the acquisition of any property from or services by any person known to be a party in interest, except in exchange for adequate consideration.

"(d) This section does not prohibit any fiduciary from—

"(1) receiving any benefit which the fiduciary is entitled to receive under this chapter as a participant, a former participant, or a beneficiary of a participant or former participant;

"(2) receiving any reasonable compensation authorized by this title for services rendered, or for reimbursement of expenses properly and actually incurred, in the performance of the fiduciary's duties under this chapter; or

"(3) serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

"(e)(1)(A) Any fiduciary that breaches the responsibilities, duties, and obligations set out in subsection (b) of this section or violates subsection (c) of this section shall be liable to the Thrift Savings Fund for any losses to such fund resulting from each such breach or violation and to restore to such fund any profits made by the fiduciary through use of assets of such fund by the fiduciary, and shall be subject to such other equitable or remedial relief as a court considers appropriate. A fiduciary may be removed for a breach referred to in the preceding sentence.

"(B) The Attorney General of the United States may assess a civil penalty against a party in interest engaging in a transaction prohibited by subsection (c) of this section. The amount of such penalty may not exceed 5 percent of the amount involved (as defined in section 4975(f)(4) of the Internal Revenue Code of 1954); except that, if the transaction is not corrected (in such manner as the Attorney General shall prescribe by regulation consistent with section 4975(f)(5) of the Internal Revenue Code of 1954) within 90 days after the date the Attorney General transmits notice to the party in interest (or such longer period as the Attorney General may permit), such penalty may be in an amount not more than 100 percent of the amount involved.

"(C) A fiduciary shall not be liable under subparagraph (A) of this paragraph with respect to a breach of fiduciary duty under subsection (b) of this section committed before becoming a fiduciary or after ceasing to be a fiduciary.

"(2) A civil action may be brought in the district courts of the United States—

"(A) by the Attorney General of the United States—

"(i) to determine and enforce a liability under paragraph (1)(A) of this subsection; or

"(ii) to collect any civil penalty under paragraph (1)(B) of this subsection; or

"(B) by the Attorney General of the United States, any participant, annuitant, former participant who is entitled to a deferred annuity under section 8412 of this title, other beneficiary, or fiduciary—

"(i) to enjoin any act or practice which violates any provision of subsection (b) or (c) of this section; or

"(ii) to obtain any other appropriate equitable relief to redress a violation of any such provision.

"(3) An action may not be commenced under paragraph (2) of this subsection with respect to a fiduciary's breach of any responsibility, duty, or obligation under subsection (b) of this section or a violation of subsection (c) of this section after the earlier of—

"(A) 6 years after (i) the date of the last action which constituted a part of the breach or violation, or (ii) in the case of an omission, the latest date on which the fiduciary could have cured the breach or violation; or

"(B) 3 years after the earliest date on which the plaintiff had actual knowledge of the breach or violation; except that, in the case of fraud or concealment, such action may be commenced not later than 6 years after the date of discovery of such breach or violation.".

(b) The table of chapters at the beginning of part III of such title is amended by inserting after the item relating to chapter 83 the following new item:

"84. Civil Service Pension System.. 8401."

TITLE II—AMENDMENTS RELATING TO SOCIAL SECURITY

AMENDMENTS TO THE SOCIAL SECURITY ACT

SEC. 201. Section 210(a)(5) of the Social Security Act is amended—

(1) by striking out "or" at the end of subparagraph (F);

(2) by striking out the semicolon at the end of subparagraph (G) and inserting in lieu thereof ", or"; and

(3) by adding at the end thereof the following new subparagraph:

"(H) service performed by an individual after such individual has commenced participation in the Civil Service Pension System pursuant to section 8471 of title 5, United States Code;".

AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 202. Section 3121(b)(5) of the Internal Revenue Code of 1954 is amended—

(1) by striking out "or" at the end of subparagraph (F);

(2) by striking out the semicolon at the end of subparagraph (G) and inserting in lieu thereof ", or"; and

(3) by adding at the end thereof the following new subparagraph:

"(H) service performed by an individual after such individual has commenced participation in the Civil Service Pension System pursuant to section 8471 of title 5, United States Code;".

TITLE III—MISCELLANEOUS AND CONFORMING AMENDMENTS

EXTENSION OF FEDERAL EMPLOYEES' RETIREMENT CONTRIBUTION TEMPORARY ADJUSTMENT ACT OF 1983

SEC. 301. (a) Sections 202(1), 202(6), 203(a)(4)(A), 203(a)(4)(B), 204(a), 206(b)(2)(A)(i), and 206(c)(3) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 (97 Stat. 1106; 5 U.S.C. 8331 note) are amended by striking out "January 1, 1986" each place it appears and inserting in lieu thereof "January 1, 1987".

(b) Section 205 of such Act is amended by striking out "and 1986" in subsections (b) and (c) and inserting in lieu thereof "1986, and 1987".

MISCELLANEOUS AMENDMENTS TO CHAPTER 83 OF TITLE 5, UNITED STATES CODE

SEC. 302. (a) Section 8331(1)(G) of title 5, United States Code, is amended to read as follows:

> "(G) an individual first employed by the government of the District of Columbia before January 1, 1987;".

(b) Section 8332 of such title is amended by adding at the end thereof the following new subsection:

"(n) Except as provided in section 8472(b) of this title, service performed while a participant in the Civil Service Pension System under chapter 84 of this title is not creditable under this section.".

(c)(1) The first sentence of section 8333(b) of such title is amended by inserting "or chapter 84 of this title" after "subject to this subchapter".

(2) Section 8333(c) of such title is amended by adding at the end thereof the following new sentence: "The requirements of the first sentence shall apply only with respect to the civilian service performed by a Member while not a participant in the Civil Service Pension System under chapter 84 of this title.".

(d) Subsection (a) of section 8334 of such title is amended—

(1) in the first sentence of paragraph (1), by striking out "The employing" and inserting in lieu thereof "Except as provided in paragraph (3) of this subsection, the employing"; and

(2) by adding at the end thereof the following new paragraph:

"(3)(A) In the case of an employee or Member who was subject to this subchapter before January 1, 1984, and whose service—

"(i) is employment for the purposes of title II of the Social Security Act and chapter 21 of the Internal Revenue Code of 1954; and

"(ii) is not creditable service for any purpose under chapter 84 of this title, an employing agency shall deduct and withhold from the basic pay of the employee or Member under paragraph (1) of this subsection during any pay period only the amount computed pursuant to subparagraph (B) of this paragraph.

"(B) The amount deducted and withheld from basic pay during any pay period pursuant to subparagraph (A) of this paragraph in the case of an employee or Member referred to in such subparagraph shall be the excess of—

"(i) the amount determined by multiplying the percent applicable to the employee or Member under paragraph (1) of this subsection by the basic pay payable for such pay period, over

"(ii) the amount of the taxes deducted and withheld from such basic pay under section 3101(a) of the Internal Revenue Code of 1954 for such pay period.".

(e) Section 8339 of such title is amended by adding at the end thereof the following new subsection:

"(o)(1) Effective on the first day of the month in which an annuitant or a survivor becomes 62 years of age, the annuity or survivor annuity computed under the other subsections of this section shall be reduced by an amount equal to the amount (if any) by which the annuitant's or survivor annuitant's benefit under title II of the Social Security Act exceeds the amount of such benefit to which he would be entitled if the service described in paragraph (2) of this subsection were not taken into account.

"(2) The service described in this paragraph is the civilian service that is covered by amounts deducted and withheld as provided in section 8334(a)(3) of this title and is taken into account for the purpose of computing—

"(A) the annuity or survivor annuity; and

"(B) benefits under such title of the Social Security Act.".

(f) Section 8347(a) of such title is amended by adding at the end thereof the following: "The Office may contract for the performance of administrative services necessary to carry out its responsibilities under this subchapter.".

(g) Section 8348(a) of such title is amended—

(1) in paragraph (1)(A), by inserting "or the provisions of chapter 84 of this title which relate to benefits payable out of the Fund" after "subchapter"; and

(2) in paragraph (2), by inserting ", chapter 84 of this title," after "chapter".

CONFORMING PROVISIONS FOR THE POSTAL SERVICE RETIREMENT SYSTEM

SEC. 303. Section 1005(d) of title 39, United States Code, is amended to read as follows:

"(d) Officers and employees of the Postal Service (other than the Governors) shall be covered by chapters 83 and 84 of title 5 according to the provisions of such chapters. The

Postal Service shall withhold from pay and shall pay into the Civil Service Retirement and Disability Fund the amounts specified in or determined under such chapter 83. The Postal Service shall pay into the Civil Service Retirement and Disability Fund the amounts specified or determined under subchapters II and V of such chapter 84. The Postal Service shall pay into the Civil Service Thrift Savings Fund the amounts specified in or determined under subchapter III of such chapter 84.".

GROUP LIFE INSURANCE FOR CERTAIN PARTICIPANTS IN THE CIVIL SERVICE PENSION SYSTEM

SEC. 304. (a) Subsection (b) of section 8702 of title 5, United States Code, is amended—

(1) by inserting "(1)" after "(b)"; and

(2) by adding at the end thereof the following new paragraph:

"(2) Paragraph (1) of this subsection shall not apply to an employee who is required by section 8402 of this title to be a participant in the Civil Service Pension System.".

(b) Subsection (a) of section 8707 of such title is amended—

(1) by striking out "(a) During" and inserting in lieu thereof "(a)(1) Except as provided in paragraph (2) of this subsection, during"; and

(2) by adding at the end thereof the following new paragraph:

"(2) Paragraph (1) of this subsection shall not apply to an employee who is required by section 8402 of this title to be a participant in the Civil Service Pension System.".

(c) Subsection (a) of section 8708 of such title is amended—

(1) by striking out "(a) For" and inserting in lieu thereof "(a)(1) Except as provided in paragraph (2) of this subsection, for"; and

(2) by adding at the end thereof the following new paragraph:

"(2) For each period for which an employee referred to in section 8707(a)(2) of this title is insured under a policy of insurance referred to in paragraph (1) of this subsection, a sum equal to one and one-half times the amount which, but for such section 8707(a)(2), would be withheld from the pay of the employee under section 8707(a)(1) of this title shall be contributed from the appropriation or fund which is used to pay the employee.".

HEALTH BENEFIT PLAN ELIGIBILITY FOR FORMER SPOUSES

SEC. 305. (a) Section 8901(10) of title 5, United States Code, is amended—

(1) in subparagraph (C)(i)—

(A) by inserting "or 8467" after "8345(j)"; and

(B) by inserting "or 8434" after "8341(h)"; and

(2) in subparagraph (C)(ii)—

(A) by inserting "or 8434" after "8341(h)"; and

(B) by inserting "or 8467" after "8345(j)".

(b)(1) Subsection (b) of section 8905 of such title is amended—

(A) by redesignating subparagraphs (A), (B), and (C) of paragraph (1) as clauses (i), (ii), and (iii), respectively;

(B) by redesignating paragraphs (1) and (2) as subparagraphs (A) and (B), respectively;

(C) by inserting "(1)" after "(b)"; and

(D) by adding at the end thereof the following new paragraph (2):

"(2) A member of family of a deceased employee or annuitant who was enrolled in a health benefit plan under this chapter on the date of death of the employee or annuitant may continue the enrollment under the conditions of eligibility prescribed in regulations issued by the Office.".

(2) Subsection (c)(1) of such section is amended—

(A) in subparagraph (B), by inserting "or 8435(a)(1)"; and

(B) in the second sentence—

(i) by inserting "or 8434" after "8341(h)"; and

(ii) by inserting "or 8467" after "8345(j)".

EMPLOYEES OF CERTAIN NONAPPROPRIATED FUND INSTRUMENTALITIES

SEC. 306. Section 2105(c) of title 5, United States Code, is amended by inserting ", chapter 84," after "chapter 81" in clause (2) of the first sentence.

TITLE IV—AUTHORIZATION AND EFFECTIVE DATES

FIRST YEAR EXPENSES OF THE CIVIL SERVICE THRIFT INVESTMENT MANAGEMENT SYSTEM

SEC. 401. (a) Notwithstanding section 8426(c)(3) of title 5, United States Code, as added by section 101 of this Act, the expenses incurred in the administration of the Civil Service Thrift Investment Management System prescribed in subchapter VIII of chapter 84 of such title, as added by section 101 of this Act, during fiscal years 1986 and 1987 shall be paid from sums appropriated pursuant to subsection (b).

(b) There are authorized to be appropriated to the Civil Service Thrift Investment Board, for fiscal years 1986 and 1987, such sums as may be necessary to pay the expenses incurred in the administration of the Civil Service Thrift Investment Management System prescribed in subchapter VIII of chapter 84 of title 5, United States Code, as added by section 101 of this Act, during such fiscal years.

EFFECTIVE DATES

SEC. 402. (a) Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect January 1, 1987.

(b) Subchapter VIII of chapter 84 of title 5, United States Code (relating to the Civil Service Thrift Investment Management System), as added by section 101, shall take effect on the date of enactment.

(c) The program required by section 8426(e) of title 5, United States Code, as added by section 101(a) of this Act, shall be established not later than January 1, 1988.

Senate retirement proposal for
new federal employees (S. 1527)

and comparison with current
Civil Service Retirement System

1. BASIC PENSION PLAN

	Current CSRS	S. 1527 (July 30, 1985)
Eligibility	Federal employees who are not covered by social security.	Federal employees who are covered by social security.
Required employee contributions	7% of total pay.	None, except for social security.
Vesting of retirement benefits	5 years service, provided employee does not withdraw his own contributions.	5 years service.
Salary base	Average of high-3 yrs salary.	Average of high-5 yrs salary.
Retirement benefit formula (accrual rate)	1.5% x first 5 yrs. service, 1.75% x next 5 yrs. service, 2.0% x yrs. of svc. over 10; all times salary base.	1.0% times years of service.
Eligibility for retirement		
1. Unreduced	Age 55 & 30 years service, Age 60 & 20 years service, Age 62 & 5 years service.	Age 62 & 5 years service.
2. Reduced	No provisions.	Age 55 & 10 years service.
3. Involuntary	Age 50 & 20 yrs. service. Any age & 25 yrs. service.	Age 50 & 20 yrs. service. Any age & 25 yrs. service.
4. Deferred vested	At least 5 yrs. service, and does not withdraw employee contributions.	At least 5 yrs. service when employment terminates.
Amount of retirement benefits		
1. Unreduced	Based on accrual rate, without reduction.	Based on accrual rate, without reduction.
2. Reduced	No provisions.	(A) Age 55 & 30 yrs. service, benefit reduced 2% for each year under age 62. (B) Age 55 & 10 yrs. service, benefit reduced 5% for each year under age 62.
3. Involuntary	Reduced 2% for each year under age 55.	Reduced 2% for each year under age 62.
4. Deferred vested	Accrued benefit payable at age 62.	Full accrued benefit payable at age 62. Reduced benefit can be elected when former employee attains age 55 with the service needed for early retirement (10 years or 30 years), with reductions at 5% or 2% per year under 62.
Refunds	Option to withdraw at separation sums contributed with benefits forfeited.	No contributions, thus no refund.
Cost-of-living adjustments (COLAs)	Annually, 100% of rate of inflation as measured by increase in Consumer Price Index (CPI).	Annually, equal to rate of increase in CPI, minus 2 percentage points.
Optional forms of benefits	Joint-&-survivor annuity. (Survivor annuity is 55% of employee's unreduced annuity. If spouse dies first, annuity to employee is restored to unreduced amount.) Subsidized (less than full actuarial reduction).	1. Joint-&-survivor annuity. (Survivor annuity is 50% of employee's reduced annuity. If spouse dies first, annuity to employee is restored to unreduced amount.) 2. Social security leveling option. (Benefits are higher at age 55-62, lower after 62.) Full actuarial reduction.
Suspension of benefits during re-employment	Applies only to involuntary retirement cases.	Applies to all retirements.

2. THRIFT-SAVINGS PLAN

<table>
<tr><th></th><th>Current CSRS</th><th>S. 1527 (July 30, 1985)</th></tr>
<tr><td>Contributions (excluded from gross income for tax purposes before account is paid out):</td><td></td><td></td></tr>
<tr><td>1. Paid by employee and matched by employer</td><td>N/A</td><td>Up to 5% of pay, with employer matching at $1 for each $1.</td></tr>
<tr><td>2. Additional voluntary employee contributions, not matched by employer</td><td>N/A</td><td>Up to 5% of pay.</td></tr>
<tr><td>Vesting</td><td>N/A</td><td>Employee is immediately vested for own contributions, employer contributions vested at 20% after 1 year of service, increasing to 100% after 5th year, with any investment gains/losses.</td></tr>
<tr><td>Investments</td><td></td><td></td></tr>
<tr><td>1. Employee may elect investment of own account in:</td><td>N/A</td><td>Fund A--Government securities.
Fund B--Fixed-income securities, using insurance company Guaranteed Investment Contracts (GICs) or other private-sector assets.
Fund C--Equities, using an index fund (invested in proportion to a diversified common stock portfolio such as Standard & Poor's 500 Stock Index).</td></tr>
<tr><td>2. Phase-in of private-sector investment option after thrift plan contributions begin:</td><td></td><td>
<table>
<tr><th rowspan="2">Contrib-utions in cal. year</th><th colspan="2">Required to be in gov't securities</th></tr>
<tr><th>Employee</th><th>Employer</th></tr>
<tr><td>1986</td><td>N/A</td><td>N/A</td></tr>
<tr><td>1987</td><td>100%</td><td>100%</td></tr>
<tr><td>1988</td><td>80</td><td>100</td></tr>
<tr><td>1989</td><td>60</td><td>100</td></tr>
<tr><td>1990</td><td>40</td><td>100</td></tr>
<tr><td>1991</td><td>20</td><td>100</td></tr>
<tr><td>1992</td><td>0</td><td>100</td></tr>
<tr><td>1993</td><td>0</td><td>80</td></tr>
<tr><td>1994</td><td>0</td><td>60</td></tr>
<tr><td>1995</td><td>0</td><td>40</td></tr>
<tr><td>1996</td><td>0</td><td>20</td></tr>
</table>
</td></tr>
<tr><td>Payout of employee retirement accounts</td><td>N/A</td><td>Employee may elect payout of vested account balance:
1. As annuity.
2. In cash (at retirement age or death).
3. As rollover to IRA (at termination of employment or death).
Active employees may not withdraw funds.
Hardship loans to employees are to be allowed on or after January 1, 1988.</td></tr>
</table>

3. SURVIVOR BENEFITS

	Current CSRS	S. 1527 (July 30, 1985)
Preretirement death benefit, spouse or former spouse.	At death of active employee with 18 months service, surviving spouse gets 55% of: (A) annuity earned at death, or, if larger, the lesser of (B) or (C). (B) 40% of salary base, or (C) annuity earned with service projected to age 60 at same salary base. Group life insurance benefits also are payable, if employee elects to contribute part of cost.	Surviving spouse may get: (A) Any social security benefits payable. (B) Group life. Employer pays the full cost of basic group life amount equal to the basic amount under current law. (This is one times annual pay rounded to next higher $1,000, plus $2,000, at ages 45 and over, and is higher for those under age 45.) (C) At death of individual who is eligible to retire, lifetime pension equal to 50% of pension, reduced for early retirement and for election of 50% joint-and-survivor annuity. (D) At death of individual who is vested but not eligible to retire, lifetime benefit (commencing when the individual first would have been eligible to retire) equal to 50% of pension, reduced for early retirement and for election of 50% joint-and-survivor annuity. (E) Thrift plan account.
Preretirement death benefit, children	Unrelated to annuity; annually adjusted dollar amount varied by number of children, and whether or not orphaned.	None from plan; benefits provided by social security.
Optional post-retirement death benefit, spouse or former spouse	55% of earned retirement annuity unless choice jointly rejected; option results in 2.5% reduction to first $3,600 of annuity and 10% reduction to annuity over $3,600.	Annuity to married retiree is automatically reduced actuarially as in a 50% joint-and-survivor option to provide spouse a survivor annuity. (Automatic unless choice is jointly rejected.)
Children	Same as for pre-retirement death benefit.	None from plan; benefits provided from social security.
Special provisions for surviving former spouses, or new spouses due to marriage after retirement.	Benefits are the same as for surviving spouses, subject to elections and deposits in certain cases.	Benefits are the same as for surviving spouses, subject to elections and deposits in certain cases.

4. DISABILITY BENEFITS

	Current CSRS	S. 1527 (July 30, 1985)
Administration and eligibility	Provided from CSRS, if employee has 5 years of service for eligibility. Customarily paid after sick leave is used up.	Provided under separate Long-Term Disability (LTD) plan with third-party administrator. Disability benefits are paid first from unused sick leave, then after no further waiting period from LTD plan, if employee has 18 months of service for LTD eligibility.
Definition of disability	Unable to do any job for which the employee is qualified in the same agency at the same grade level.	Employee must meet one of two definitions of disability-- 1. Social Security definition: Unable to work in substantial gainful activity. 2. Occupational definition: Unable to do any job for which the employee is qualified in the same agency and commuting area, at the same grade level. During disability, total income from work may not exceed 60% of pay level for former job, and employee may be given physical exams.
Disability benefit amounts	Annuity earned at onset, or if greater, the lesser of: (a) 40% of salary base, or (b) annuity based on service projected to age 60 at the same salary base.	60 percent of high-5, offset after 5-month waiting period by 100% of social security primary benefit, if any, payable to age 62. If employee meets only the occupational definition of disability, benefits are reduced one year after they begin to 40 percent of high-5, payable to age 55. Disability benefits are adjusted each year to reflect both inflation and the increase in any social security offset.
Retirement benefits after disability	Disability pension continues for life if no recovery before normal retirement age.	During LTD benefit period, employee's service continues to be credited toward basic retirement benefit formula, high-5 goes up by the same COLA used for the basic pension plan, and employee may participate in thrift plan After long-term disability benefit period ends, employee is eligible for retirement benefits based on age and service at that time.

5. OTHER PROVISIONS

	Current CSRS	S. 1527 (July 30, 1985)
Retirement ages for law enforcement, firefighters, air traffic controllers, etc.	Law enforcement officers and firefighters may retire at age 50 & 20 years service. Benefit is 2.5% of high-3 times first 20 years of service, plus 2% times service beyond 20 years. Air traffic controllers may retire after 25 years, or at age 50 & 20 years, with unreduced benefits under the regular formula, but not less than 50% of high-3. Other groups have special contributions, benefits.	Law enforcement, firefighters, and air traffic controllers may retire at age 55 with 25 years of service. Supplement equal to social security payable between ages 55-62. National guard technicians may retire at age 55 with 30 years service, with no supplement payable. These classes may retire before age 55, if they have 25 years of service, with reduction of 5% per year below age 55, and with no supplement payable before 55. Other groups get the regular benefits of the plan.
Treatment of non-federal employees as federal employees for purposes of retirement	Certain groups are included.	Newly hired employees of the D.C. government are excluded from this program. Other non-federal employees retain current coverage.
Transfers of current employees to new program	N/A	Current employees may elect to join social security and new program through Dec. 31, 1987. Credit in current program stops, except that the high-3 pay continues to run. Employee retains survivor coverage from current plan, but not disability coverage. All service counts toward both programs' eligibility for retirement and vesting. Employee is given credit for prior federal service toward eligibility for long-term disability coverage, and the social security windfall-benefit reduction and public-pension spouse offset are waived.
Effective date and transition from interim plan		Effective date is Jan.1, 1987. Participants who contributed toward interim plan after 1983 receive credit toward thrift plan for these contributions and matching employer contributions plus interest.

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25 July 1985

TO : Senate Committee on Governmental Affairs
Senate Subcommittee on Civil Service, Post Office and General Services

FROM : Dennis Snook, Leader
Civil Service Retirement Team

SUBJECT : CRS Analysis of the Stevens-Roth Plan for a Retirement System for Federal Workers Covered by Social Security

As you requested, the following report presents costs and benefit projections for a Civil Service Retirement plan for Federal employees who became covered by social security as a result of the Social Security Amendments of 1983. The plan was developed under the guidance of Senators Ted Stevens and William Roth, Chairmen of the Subcommittee on Civil Service, Post Office, and General Services, and of the full Committee on Governmental Affairs, respectively. Details of the plan were devised by the committee staffs.

The report does not address arguable pros and cons of this plan, its effect upon the Federal workforce, or the sensitivity of the capital accumulation component to investment vehicles with rates of return different from those assumed for the basic cost projections. The analysis is confined to "new" Federal workers, those who started work after December 31, 1983. It assumes that other Federal workers will remain in the old CSRS. All projections are accomplished using an "entry age normal cost" actuarial approach for new workers.

This report was prepared by the Congressional Research Service (CRS) Civil Service Retirement Team, a group of analysts with expertise on issues pertaining to the design of a new system for those Federal employees covered by social security.

Data for this report were generated from the CRS retirement pension cost and replacement rate models. Certain details of the design, after consultations with the staff of the Committee on Governmental Affairs, were elaborated by CRS to accommodate the CRS analytic models. The methodology and format for presentation used for the analysis were developed for the study, "Designing a Retirement System for Federal Workers Covered by Social Security," published as Committee Print 98-17 by the House Post Office and Civil Service Committee. Analysts responsible for sections of this paper are the following:

Michael Burke, data presentation
Tom Gabe, methods and data development
Rich Hobbie, capital accumulation plan
Geoffrey Kollmann, disability benefits
Carolyn Merck, survivor and family benefits
Mike O'Grady, methods and data development
Mary Pilote, graphics
Ray Schmitt, capital accumulation plan
Dennis Snook, retirement benefits

Mary Anderson, Lea Barber and Arleen Scuka typed this report and Ms. Barber coordinated its production.

Edwin Hustead and Michael Sullivan of Hay-Huggins, Inc., provided actuarial and other technical assistance.

The report is divided into five sections, as listed below:

o Section I is a general description of the plan.

o Section II compares the Stevens-Roth provisions to those of the current Civil Service Retirement System (CSRS).

o Section III contains data from the cost projection model for the long term. No short term costs are shown.

o Section IV displays graphically the benefit distributions for affected workers. Tables of the percentage of preretirement salaries replaced by benefits for selected workers retiring in 2030 are also included.

o Section V is a brief description of the analytic framework, assumptions and actuarial models used to produce the response.

ANALYSIS OF THE STEVENS-ROTH PLAN: A RETIREMENT PLAN FOR FEDERAL WORKERS COVERED BY SOCIAL SECURITY

I. DESCRIPTION OF THE PLAN

This pension design was developed under the leadership of Senator Ted Stevens, Chairman of the Subcommittee on Civil Service, Post Office and General Services, and Senator William Roth, Chairman of the Committee on Governmental Affairs. Details of the plan were specified by the staff of both the subcommittee and the full committee. CRS is using its pension evaluation models to analyze this plan, but takes no position on any of its features.

A. General Design

This pension design is for Federal civil servants who are covered by social security. Workers first hired after December 31, 1983 would automatically participate as would certain other categories of workers with service before that date. Employees exempted from participation in social security would be given an opportunity to waive that exemption and become participants in this arrangement.

The general design of the system includes, in addition to social security, a defined benefit plan and a capital accumulation plan. Workers would participate automatically in the defined benefit plan, which would be entirely funded from Federal funds. Workers could contribute as much as 10 percent of their salaries to the capital accumulation plan of which the first five percent is matched dollar-for-dollar by their employing Federal agency. For purposes of this analysis, the accumulating matching funds are assumed to be invested in instruments that reflect performance of the economy using the same assumptions as are used to project costs and benefits for the defined benefit component.

B. Retirement

1. Defined benefit

A defined benefit plan is one in which a formula and a definition of eligibility determine benefit awards. In this case, workers would earn 1.0 percent of the average of their highest five consecutive years of wages for each year of service completed. Wages are not "capped" for computation purposes; that is, retirement benefits are calculated using salaries that have not been limited by a statutory maximum payable amount.

Basic benefits from the defined benefit pension would be fully payable at age 62 with 5 years of service. Workers could choose to retire at age 55 with 30 years of service, with reductions of two percent for each year under age 62 at retirement. Participants could also choose to retire at age 55 with less than 30 years of service but more than 10 years, but benefits would be reduced by five percent for each year under age 62 at retirement.

Workers separated involuntarily with at least 25 years of service or after age 50 with at least 20 years would be eligible for benefits reduced by two percent per year for retirement before age 62.

Deferred benefits would be payable at age 62 for workers who separated with at least five years of service, or reduced benefits would be payable at age 55 with 10 years of service at separation.

Cost-of-living adjustments would be paid annually at two percentage points less than the rate of inflation as measured by the Consumer Price Index (CPI).

These projections, which are based upon a level long-term inflation assumption of four percent per year, would therefore increase in nominal terms by two percent per year.

2. Capital Accumulation

The plan includes a defined contribution plan in the form of a voluntary capital accumulation plan that would supplement the main retirement benefit.

A voluntary capital accumulation plan is one in which an employee accumulates assets in the form of a pretax savings account that can be furnished upon separation in a lump sum or converted to an annuity at the point at which the employee retires. In this proposal, a program of individual capital accumulation accounts is created from employee money voluntarily contributed, with Federal funds added to encourage participation. Employees would be permitted to contribute up to 10 percent of their salaries to the plan, with the first five percent matched by one dollar for each dollar contributed. Under certain conditions, employees would have access to their funds before retirement. If an employee separated from Federal service before becoming eligible to receive an annuity, the accumulated sums could be transferred and maintained on a tax-deferred basis in an Individual Retirement Account (IRA).

3. Employee Contributions

Employees would be required to contribute to social security. The cash benefits (old-age, survivors, and disability insurance) tax-rate is 5.7 percent of pay in 1985 (6.06 beginning in 1988; 6.20 beginning in 1990) up to a maximum taxable wage level ($39,600 in 1985) that is indexed to the annual growth in wages as measured for the economy at large.

There are no mandatory contributions to the defined benefit plan.

The capital accumulation plan, as mentioned, permits employee contributions up to 10 percent of pay with 5 percent of pay matched equally by employer contributions. Thus, those employees fully contributing up to the matching limit would receive the full value of the maximum potential employer cost for the overall retirement system, and employees contributing less would receive corresponding smaller shares of that potential employer commitment.

Employees with salaries below the social security maximum taxable base could therefore pay between 5.7 and 10.7 percent of total salary in 1985, with the latter amount necessary to receive maximum potential value of the employer retirement commitment. As the scheduled increases to the social security tax rate are phased in, these amounts would rise. Employees with salaries above the maximum would pay somewhat smaller rates as a mandatory percentage of total salary. For example, employees at a salary of $45,000 annually would have a mandatory payment of approximately 5 percent of total salary in 1985 and thus could pay up to a maximum of about 10 percent of pay to receive maximum value. CRS estimates that the employee with average wages and average contributions to the capital accumulation plan would be paying about 8.7 percent of total pay under this plan in 1985.

C. Disability Benefits

A long term disability (LTD) insurance plan provided by the Government and administered by a third party would pay disability benefits to employees who are unable, because of sickness or injury, to perform the duties of their job. Employees would be eligible at any age for disability benefits after 18 months of creditable service and exhaustion of all sick leave. After the first year of entitlement to LTD benefits, the employee must be unable to do any

Federal job in the same commuting area and within the same or similar grade level of his former job. During the first year of entitlement, the amount of the disability benefit would be 60 percent of average yearly pay, based on the highest five consecutive years of salary or, if the employee has been employed for less than five years, on average pay over the total employment period. In subsequent years of entitlement, the amount of disability would be 60 percent if eligible for social security; 40 percent if not eligible.

Disabled workers would be required to apply for social security disability. If they become entitled to social security disability benefits, the social security primary benefit would be subtracted from the LTD benefit, and the LTD benefit would continue until the worker is recovered or reaches age 62. If the worker does not meet the social security definition of disability, the LTD benefit would be reduced after one year to 40 percent of average yearly salary, and would continue until the worker is recovered or reaches age 55.

At the discretion of the third party administrator, the beneficiary may be required to undergo periodic medical reevaluations. If he is found to have recovered, his benefit would cease. Beneficiaries also would be required to report their earnings each year. If in any calendar year the beneficiary's income from work is at least 60 percent of the current salary of the position from which that person retired, his earnings capacity would be considered restored and benefits would cease.

In computing the LTD benefit, annual average salary would be increased by two percentage points less than inflation. If the worker is entitled to social security disability benefits, the amount of social security subtracted from the LTD benefit in any one month would be the worker's social security benefit, including subsequent COLAs.

During the LTD benefit period, the employee's service would continue to be credited toward the defined benefit formula, and the high-five amount would go up by two percentage points less than inflation. The employee could withdraw his accrued benefits from the defined contribution part of the retirement plan, but he also would have the option of continuing to participate. After the LTD benefit period ends, employees would be eligible for retirement benefits based on age and service at that time.

D. Survivor Benefits

1. Preretirement Death

Surviving spouses of workers who die after becoming "fully insured" under social security (generally 40 quarters of covered employment) are eligible for spouse survivor benefits if they are over age 59 (49 if fully disabled). Social security mother's and father's benefits are paid to survivors of any age if the deceased worker had at least six quarters of covered employment and if the surviving spouse is responsible for the care of a child under the age of 16 (or disabled) of the deceased worker. In general, the marriage must have lasted nine months. Benefits are terminated if the survivor remarries before age 60.

In addition to social security survivor benefits, the pension plan would provide benefits to the spouse of a worker who dies after having reached eligibility for early retirement (age 55 with at least 10 years of service) or for full retirement benefits (age 62). The survivor benefit would be computed as if the worker had retired the day before death and elected a 50 percent joint-and-survivor plan; early retirement reductions would be applied (2 percent for each year the worker was under age 62, but was at least age 55 and had 30 or more years of service; 5 percent for each year the worker was under age 62, but was at least age 55 and had more than 10 but fewer than 30 years of service).

If the vested worker dies before the earliest age of eligiblity based upon accrued service at death, survivor benefits from the pension plan would not begin until the date on which the deceased worker would have reached the age of eligiblity. If the worker had fewer than 30 but more than 10 years of service at the time of death, benefits could begin on the deceased worker's 55th birthday, but the five percent early retirement reduction would be made for each year under age 62. Thus, when survivor benefits became payable, they would be based on a pension reduced by 35 percent. If the worker had 30 years of service at the time of death, a two percent early retirement reduction would be made for each year under age 62. Thus, the survivor benefits would be based on a pension reduced by 14 percent for early retirement.

Any balance in the capital accumulation plan would be payable to the surviving spouse and could be paid either in a lump sum, or as a life annuity. If there is no surviving spouse, or other named beneficiary, the account balance would become part of the deceased worker's estate.

2. Postretirement Death

Social security spouse survivor benefits are payable when the widow or widower of a retiree (who was eligible for social security retirement benefits) is over age 59 (subject to an earnings test) or over age 49 if completely disabled. Social security mother's and father's benefits are paid to surviving spouses of any age if caring for child under age 16 (or disabled) of the deceased worker or retiree. The marriage must have lasted at least nine months; social security benefits are discontinued if the spouse remarries before age 60.

Under the pension plan, retiring married workers automatically provide a 50 percent joint-and-survivor benefit, for which a full actuarial reduction is made in the annuity of the retiree. This coverage is mandatory unless jointly rejected. Thus, in addition to any social security payable, the surviving spouse of a retiree would receive 50 percent of the amount the retiree had been receiving before death; the retiree's annuity would have been reduced by roughly 10 to 13 percent to cover the cost of paying a spouse survivor benefit and for early retirement, if applicable.

At the time of retirement the worker would specify the form in which benefits from the capital accumulation plan would be paid. If an election is made to receive an annuity with an actuarially determined survivor benefit, then the spouse survivor would receive that benefit in addition to the joint-and-survivor benefit from the defined benefit plan.

3. Group Life Insurance

Basic life insurance is provided at no charge to the employee. Benefits are equal to one year's salary rounded to the next $1,000 plus an additional $2,000 for all workers over age 45. Benefits are doubled for those 35 or under, and decline gradually to age 45. Workers would be allowed to purchase, at full cost, additional coverage, as they can under the current system. Post-retirement coverage, as under current law, is available. Under current law, until December 31, 1989, Federal employees retiring before age 65 retain full coverage, at no cost, up to age 65. At age 65, the government insurance declines by 2 percent per month to a minimum of 25 percent of the amount in force at retirement. Retiring employees can elect, at an extra cost, to reduce or eliminate the reduction in coverage at age 65. As of January 1, 1990, all retirees under age 65 will have life insurance premiums withheld from their annuities to retain full coverage at age 65.

4. Children's Survivor Benefits

Unlike the current CSRS, no child survivor benefits would be available from the pension plan. Instead, this need would be filled by social security. Surviving children of workers with at least six quarters of social security covered employment are eligible for social security children's benefits if they are under age 16, or under 18 if a fulltime student in elementary or secondary school. No benefits would be paid to students of any age in post-secondary school.

The capital accumulation plan could be set up to allow a retired worker to take the benefits in the form of an annuity and name someone other than a spouse as the beneficiary of a survivor benefit, and, theoretically, a child could be named. The amount of that child survivor benefit would be determined actuarially, based on the age of the named child.

II. PLAN PROVISIONS

TABLE 1. Plan Provisions

	Current CSRS	Stevens-Roth Plan
A. Social Security		
Coverage (old age, survivors, and disability insurance cash benefits (OASDI)	None	Employees covered by Social Security Amendments of 1983
Contributions	N/A	5.7% of pay (6.06 beginning in 1988; 6.20 beginning in 1990) to social security (for OASDI coverage) up to maximum taxable wage base ($39,600 in 1985)
B. Defined Benefit: Retirement		
Basic plan design	Defined benefit	Defined benefit not integrated (fully added to social security)
Required employee contributions	7% of total pay	No required contribution to new CSRS
Vesting	5 yrs. for retirement	5 yrs. for retirement, and
	5 yrs. for disability	1.5 yrs. for disability
	1.5 yrs. for preretirement death benefits	5 yrs. for preretirement death benefits
Salary base	Average of high-3 yrs. salary	Average of high-5 yrs. salary of record

TABLE 1. Plan Provisions (continued)

	Current CSRS	Stevens-Roth Plan
Retirement benefit formula (accrual rate)	1.5% x first 5 yrs. of service. 1.75% x second 5 yrs. of service. 2.0 x all yrs. of service over 10 yrs., all x salary base	1.0% x yrs. of service
Age for unreduced retirement benefits	Age 55 with 30 yrs. service. 60 with 20 yrs. service. 62 with 5 yrs. service	62 with 5 yrs. service
Early retirement; age and reductions	No provisions	(a) 55 with 30 yrs. service. Benefit reduced 2% for each yr. under age 62 (b) 55 with 10 yrs. service. Benefit reduced 5% for each yr. under age 62
Involuntary early retirement; age and reductions	Age 50 with 20 yrs. service. Any age with 25 yrs service. Benefit reduced 2% for each yr. under age 55	Same as current, but benefit reduced 2% for each yr. under age 62
Deferred retirement	At least 5 yrs. service; accrued benefit payable at age 62	At least 5 yrs. service; full accrued benefit payable at age 62, or reduced benefit at age 55 with 10 yrs. service
Refunds	Option to withdraw at separation sums contributed with benefits forfeited	No contributions, thus no refund
Cost-of-living adjustments	Annually, full rate of inflation measured by Consumer Price Index (CPI)	Annually, 2 percentage points less than the rate of inflation measured by CPI

TABLE 1. Plan Provisions (continued)

	Current CSRS	Stevens-Roth Plan
C. Disability Benefits		
Administration and eligibility	Provided from CSRS, if employee has 5 yrs. of service	To be provided under separate LTD plan with third-party administrator. Disability benefits are paid first from unused sick leave, then after no further waiting period from LTD plan if employee has 18 mos. of service for LTD eligibility
Definition of disability	Unable to do own job	During first yr. after entitlement to LTD benefits, employee must be unable to do own job. After first year employee must be unable to do any Federal job in same commuting area and same grade level. Also, total earnings from work may not exceed 60% of pay level for former job, and employee may be given physical exams
Disability benefit amounts	Annuity earned at onset, or the lower of (a) 40% of salary base, or (b) annuity that would be paid projecting service to age 60 at the same salary base	60% of high-5 offset after 5 mo. waiting period by 100% of social security primary benefit, payable to age 62 If social security definition of disability is not met, benefits reduced 1 yr. after entitlement to LTD benefits to 40% of high-5 payable to age 55 Social security amount offset will be amount payable to worker, and final pay used to compute LTD benefits will increase by two percentage points less than inflation

TABLE 1. Plan Provisions (continued)

	Current CSRS	Stevens-Roth Plan
Retirement benefits after disability	Disability pension continues for life if no recovery before normal retirement age	During LTD benefit period, employee's service continues to be credited toward defined-benefit formula, high-5 amount goes up by two percentage points less than inflation and employee may participate in defined-contribution part of plan. After LTD benefit period ends, employee is eligible for retirement benefits based on age and service at that time
D. Survivors Benefits		
Preretirement death benefit, spouse	55% of the annuity earned at death, or, if larger, the lesser of (a) 55% of 40% of salary base, or (b) 55% of annuity earned with service projected to age 60 at same salary base	Surviving spouse gets: (a) Group life insurance automatically provided at no cost to employee. Benefits for workers over age 45 are one x annual pay, rounded up to the next $1,000, plus $2,000. This amount is doubled for workers under age 35, declining gradually to age 45. Benefits are doubled in cases of accidental death. (These benefits are the same as current law, except that all employees are covered and no employee payment is required.) (b) Any social security benefits payable with no offsets

TABLE 1. Plan Provisions (continued)

	Current CSRS	Stevens-Roth Plan
		(c) At death of participant who is eligible to retire, lifetime pension equal to 50% of accrued pension, reduced for early retirement (2% per yr. under age 62 if 30 or more years of service at death and 5% per yr. if under 30 yrs. of service) and for election of 50% joint-and-survivor form (d) At death of participant who is vested but not eligible to retire, lifetime pension (commencing when the employee first would have become eligible to retire) equal to 50% of accrued pension, reduced for early retirement (as under (c) above) and for election of 50% joint-and-survivor form
Preretirement death benefit, children	Unrelated to annuity; annually adjusted dollar amount varied by number of children, and whether or not orphaned	None from plan; benefits provided by social security
Optional postretirement death benefit, spouse	55% of earned retirement annuity unless choice rejected; option results in reduction to earned retirement annuity of 2.5% of first $3,600 of annuity and 10% reduction to annuity over $3,600	Annuity to married retiree is automatically reduced actuarially as in a 50% joint-and-survivor plan to provide a spouse survivor annuity. (Automatic unless rejected.)

TABLE 1. Plan Provisions (continued)

	Current CSRS	Stevens-Roth Plan
Children	Same as for preretirement death benefit	None from plan; benefits provided from social security
Special classes	Special provisions are available for certain groups: Law enforcement, firefighters, air traffic controllers, Congress, etc.	Law enforcement, firefighters, and air traffic controllers may retire at age 55 with 25 yrs. Supplement equal to social security payable ages 55-62. National guard technicians may retire at age 55 with 30 yrs. service, with no supplement payable. These classes may retire before 55, with reduction of 5% per yr. below age 55, and without supplement payable before 55. Other groups get the regular benefits of the plan
E. Voluntary Capital Accumulation		
Employer contribution	N/A	$1 for each $1 by employees, up to 5% of pay
Employee contributions not matched	N/A	Up to additional 5% of pay
Vesting	N/A	Employee vested immediately for own contributions. Employer contributions vested at 20% after 1st yr., increasing in equal increments to 100% after 5th yr.

III. COST ESTIMATES

The following tables display the normal costs of this plan. Table 2 compares the cost of the plan to the cost of the current CSRS, using a consistent set of assumptions. The CRS model projects that the cost of the plan to the employer would be about 17 percent less than the current CSRS (including the net increased cost of basic life insurance) over the projection period. However, the total cost of the plan, including average employee contributions, would cost seven percent less than the current CSRS. Table 3 shows a breakdown of cost under the plan by benefit.

TABLE 2. Comparison of Entry Age Normal Cost Estimates of Current CSRS to Stevens-Roth Plan a/

	Current CSRS (baseline)			Stevens-Roth Plan		
	Employer share	Employee share	Total	Employer share	Employee share (average)	Total
Defined Benefit Plan	25.0%	7.0%	32.0%	11.7%	--	11.7%
Social security b/	--	--	--	5.9	5.9	11.8
FEGLI change c/	--	0.2	--	0.2	--	0.2
Capital accumulation plan (voluntary) d/	--	--	--	3.0	3.0	6.0
Full Cost e/	25.0	7.2	32.2	20.8	8.9	29.7

a/ All cost figures are rounded to the nearest tenth of a percent. Administrative costs and benefits to special groups are excluded. Under the current CSRS these costs are estimated to be 0.1 and 0.3 percent of pay, respectively.

b/ Social security cost is the percentage of total Federal payroll taxable for social security (OASDI).

c/ Increased employer cost (0.2%) of Federal Employees Group Life Insurance (FEGLI) resulting from the employer assuming the full cost of Federal worker life insurance.

d/ For employees, cost of the capital accumulation plan is shown as the average cost. Average cost is determined by dividing the projected sum of all contributions (up to the specified matching limit of five percent for each employee) by the number of employees, assuming 60 percent rate of full participation. The cost to the government is the employee cost times the matching rate minus the sum of unvested contributions forfeited (0.03%) by separating employees.

e/ Average full cost: For the existing CSRS, includes the average employee contribution for life insurance coverage while working. For Stevens-Roth, includes average employee contribution and employer match to the capital accumulation plan.

TABLE 3. Entry Age Normal Cost of Stevens-Roth Plan by Benefit a/
Normal Cost (Percent of Total Federal Pay)

DEFINED BENEFIT COMPONENT	
Annuities to employees:	
Optional retirement	8.5
Involuntary retirement	0.4
Disability retirement b/	1.0
Deferred retirement	0.6
Subtotal	10.5
Annuities to survivors of:	
Age retirees	0.8
Disability retirees	0.1
Active employees	0.3
To children	---
Subtotal	1.2
Refunds	---
TOTAL BENEFITS DEFINED BENEFITS	11.7
INCREASED COST OF FEGLI	.2 c/
TOTAL BENEFITS CAPITAL ACCUMULATION	6.0 d/
TOTAL BENEFITS SOCIAL SECURITY	11.8 e/
TOTAL BENEFITS	29.7
LESS EMPLOYEE CONTRIBUTIONS	
Defined Benefit	---
Capital Accumulation	- 3.0 d/
Social Security	- 5.9 f/
TOTAL EMPLOYER COST	20.8

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a/ Detail may not sum to totals due to rounding. Administrative costs and benefits to special groups are excluded.

b/ Includes deferred retirement benefits to disabled annuitants. (0.5%)

c/ Net increase in Federal Employees Group Life Insurance (FEGLI) from changes made to that program as part of the Stevens-Roth Plan.

d/ Based upon net employer contributions (minus forfeitures of 0.03%) average contribution for all workers including nonparticipants.

e/ Approximately 0.4 percent of payroll of the social security cost is not distributed to Federal workers but flows to relatively lower-income social security participants outside the Federal government.

f/ Social security average contribution as a percent of total payroll.

IV. REPLACEMENT RATES

The following tables and figures show the percent of gross preretirement dollars replaced by the various retirement income components. Gross replacement rates are defined as the percentage of gross preretirement wages replaced by gross postretirement benefits.

For these benefit projections, employees are assumed to be retiring in the year 2030, after all enacted changes to social security retirement age have been phased in. In 2030, the age for full social security benefits is 67 with 30 percent reduction applied to benefits received at age 62. The tables show replacement rates for single workers, by salary level, age at retirement, and service, with benefit values shown at retirement age, at age 62 and age 80. Capital accumulation amounts are indexed so that level values over time are shown. The figures show replacement rates for various combinations graphically and compare them to the current system.

The tables and figures show a range of replacement rates from the capital accumulation plan. The band ranges from rates projected for workers participating fully to those for workers participating not at all. To achieve the maximum replacement rate, these hypothetical workers would contribute to the plan five percent of before-tax pay, matched equally by an employer contribution. The maximum annuity shown in these figures implies full participation throughout the work career; conversely, the bottom line of the band displays the replacement rates for workers never participating. Experience from the private sector suggests that most workers would not exhibit either of these polar characteristics but would vary their participation, largely in response to changing personal or broader economic circumstances.

Actual participation is influenced by a worker's age, income, marginal tax rate, availability of other tax-favored savings arrangements, overall investment strategy, and preferences concerning current versus future consumption. Participation rates are also affected by the availability of loan and "hardship" withdrawal provisions. If workers did not participate in all years, had more rapid salary progressions, realized lower interest rates, or did not contribute the full five percent of pay, replacement rates from the capital accumulation plan would be lower. It is also possible that different economic experiences could produce higher rates of return and corresponding higher potential replacement rates.

Care should be taken when comparing replacement rates derived through participation in a tax-deferred capital accumulation plan with those available to nonparticipants and with replacement rates earned under the current CSRS. The higher replacement rate achieved by participation in the plan results in lower preretirement disposable income. Foregoing participation in the plan in favor of higher consumption while working would result in lower replacement rates at retirement, but a relatively higher standard of living might thereby be attained before retirement than would otherwise occur if compensation were deferred until retirement. Furthermore, earnings replacement rates shown for workers covered by the CSRS do not take into account voluntary (albeit unmatched retirement savings that these workers could make, for example, into an Individual Retirement Account (IRA). In other words, pre-1984 Federal workers who voluntarily saved five percent of pay would also have increased their earnings replacement rate above that shown in the figures for CSRS.

TABLE 4. Replacement Rates
Current Civil Service Retirement System
(in percents)

(Final salaries have been adjusted to 1985 dollars)	$15,000	$30,000	$45,000	$60,000	$75,000
Gross replacement rates					
10 years service	15%	15%	15%	15%	15%
20 years service	34	34	34	34	34
30 years service	53	53	53	53	53
35 years service	63	63	63	63	63
40 years service	72	72	72	72	72

Note: These rates are for persons retiring in the year 2030.

TABLE 5. Replacement Rates
Add-on Plan: 1 Percent Accrual Rate; CAP with 1 to 1 Match
Up to 5 Percent of Pay; 2 Percent Early Retirement Reduction;
Postretirement Adjustment: CPI - 2
(In percents)

(Final salaries have been adjusted to 1985 dollars)	$15,000	$30,000	$45,000	$60,000	$75,000
Retirement at:					
Age 55/30 years (gross rates)					
Total rate	38%	38%	38%	38%	38%
(without C.A. plan)	(23%)	(23%)	(23%)	(23%)	(23%)
Pension	23	23	23	23	23
OASDI	0	0	0	0	0
C.A. plan	15	15	15	15	15
Total rate at age 62	57%	52%	48%	45%	43%
(without C.A. plan)	(42%)	(37%)	(33%)	(30%)	(28%)
Pension	20	20	20	20	20
OASDI	22	17	13	10	8
C.A. plan	15	15	15	15	15
Total at age 80	51%	46%	42%	39%	37%
(without C.A. plan)	(36%)	(31%)	(27%)	(24%)	(22%)
Pension	14	14	14	14	14
OASDI	22	17	13	10	8
C.A. plan	15	15	15	15	15

NOTE: These rates are for persons retiring in the year 2030. Totals may not add due to rounding.

TABLE 6. Replacement Rates
Add-on Plan: 1 Percent Accrual Rate; CAP with 1-1 Match
Up to 5 Percent of Pay; 2 Percent Early Retirement Reduction;
Postretirement Adjustment: CPI - 2
(In percents)

(Final salaries have been adjusted to 1985 dollars)	$15,000	$30,000	$45,000	$60,000	$75,000
Retirement at:					
Age 62/10 years (gross rates)					
Total rate	21%	20%	19%	18%	18%
(without C.A. plan)	(15%)	(13%)	(12%)	(12%)	(11%)
Pension	9	9	9	9	9
OASDI	6	5	4	3	3
C.A. plan	6	6	6	6	6
Retirement at:					
Age 62/20 years (gross rates)					
Total rate	44%	42%	39%	37%	36%
(without C.A. plan)	(31%)	(29%)	(26%)	(24%)	(23%)
Pension	18	18	18	18	18
OASDI	14	11	8	7	5
C.A. plan	13	13	13	13	13
Total at age 80	39%	36%	34%	32%	31%
(without C.A. plan)	(26%)	(24%)	(21%)	(19%)	(18%)

Note: These rates are for persons retiring in the year 2030. Totals may not add due to rounding.

TABLE 7. Replacement Rates
Add-on Plan: 1 Percent Accrual Rate; CAP with 1-1 Match
Up to 5 Percent of Pay; 2 Percent Early Retirement Reduction;
Postretirement Adjustment: CPI - 2
(In percents)

(Final salaries have been adjusted to 1985 dollars)	$15,000	$30,000	$45,000	$60,000	$75,000
Retirement at:					
Age 62/30 years (gross rates)					
Total rate	69%	64%	60%	56%	54%
(without C.A. plan)	(50%)	(44%)	(40%)	(37%)	(35%)
Pension	27	27	27	27	27
OASDI	23	18	13	10	8
C.A. plan	19	19	19	19	19
Retirement at:					
Age 62/35 years (gross rate)					
Total rate	81%	75%	70%	66%	63%
(without C.A. plan)	(59%)	(52%)	(47%)	(44%)	(41%)
Pension	31	31	31	31	31
OASDI	27	21	16	12	10
C.A. plan	22	22	22	22	22
Total rate at age 65	79%	73%	68%	64%	62%
(without C.A. plan)	(57%)	(51%)	(46%)	(42%)	(39%)
Total rate at age 80	72%	65%	60%	57%	54%
(without C.A. plan)	(49%)	(43%)	(38%)	(34%)	(32%)

Note: These rates are for persons retiring in the year 2030. Totals may not add due to rounding.

TABLE 8. Replacement Rates
Add-on Plan: 1 Percent Accrual Rate; CAP with 1-1 Match
Up to 5 Percent of Pay; 2 Percent Early Retirement Reduction;
Postretirement Adjustment: CPI - 2
(In percents)

(Final salaries have been adjusted to 1985 dollars)	$15,000	$30,000	$45,000	$60,000	$75,000
Retirement at:					
Age 62/40 years (gross rates)					
Total rate	89%	82%	77%	73%	71%
(without C.A. plan)	(63%)	(57%)	(52%)	(48%)	(46%)
Pension	36	36	36	36	36
OASDI	28	21	16	12	10
C.A. plan	25	25	25	25	25
Retirement at:					
Age 65/30 years (gross rates)					
Total rate	76%	69%	64%	61%	58%
(without C.A. plan)	(54%)	(48%)	(43%)	(39%)	(37%)
Pension	27	27	27	27	27
OASDI	27	21	16	12	10
C.A. plan	22	22	22	22	22

Note: These rates are for persons retiring in the year 2030. Totals may not add due to rounding.

TABLE 9. Replacement Rates
Add-on Plan: 1 Percent Accrual Rate; CAP with 1-1 Match
Up to 5 Percent of Pay; 2 Percent Early Retirement Reduction;
Postretirement Adjustment: CPI - 2
(In percents)

(Final salaries have been adjusted to 1985 dollars)	$15,000	$30,000	$45,000	$60,000	$75,000
Retirement at:					
Age 67/30 years (gross rates)					
Total rate	81%	74%	68%	64%	62%
(without C.A. plan)	(58%)	(51%)	(45%)	(41%)	(38%)
Pension	27	27	27	27	27
OASDI	31	24	18	14	11
C.A. plan	23	23	23	23	23
Retirement at:					
Age 67/40 years (gross rates)					
Total rate	105%	95%	88%	83%	80%
(without C.A. plan)	(74%)	(64%)	(58%)	(52%)	(49%)
Pension	36	36	36	36	36
OASDI	38	29	22	17	13
C.A. plan	31	31	31	31	31

NOTE: These rates are for persons retiring in the year 2030. Totals may not add due to rounding.

FIGURE 1. Benefit Value at Retirement and After

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 55
Service: 30 years
Salary: $30,000 (adjusted to 1985 levels)

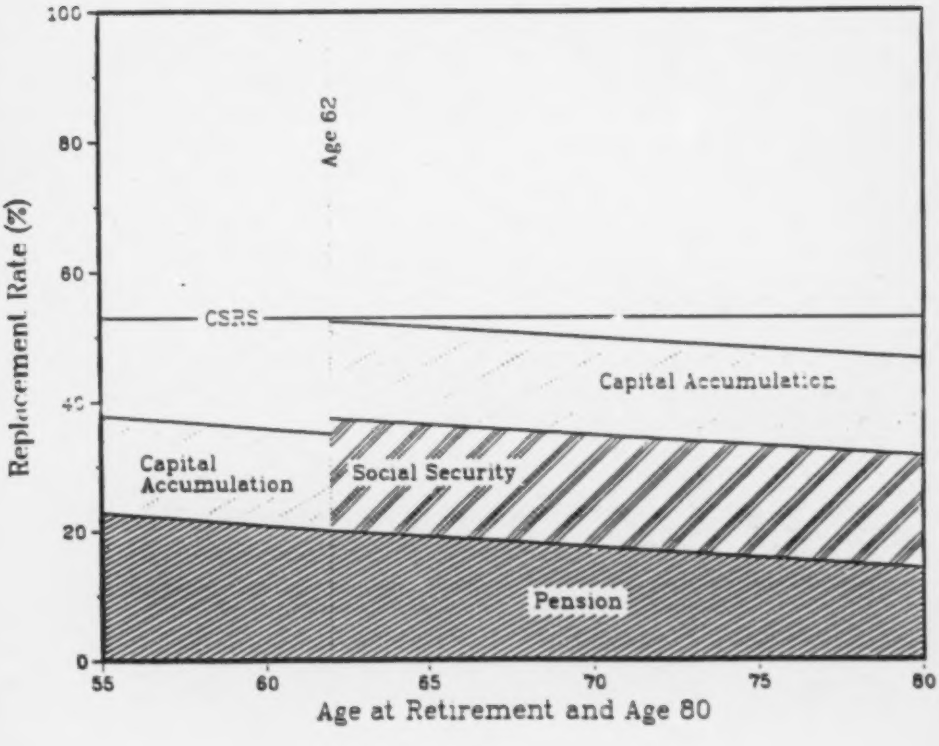


FIGURE 2. Benefit Value at Retirement and After

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 62
Service: 35 years
Salary: $30,000 (adjusted to 1985 levels)

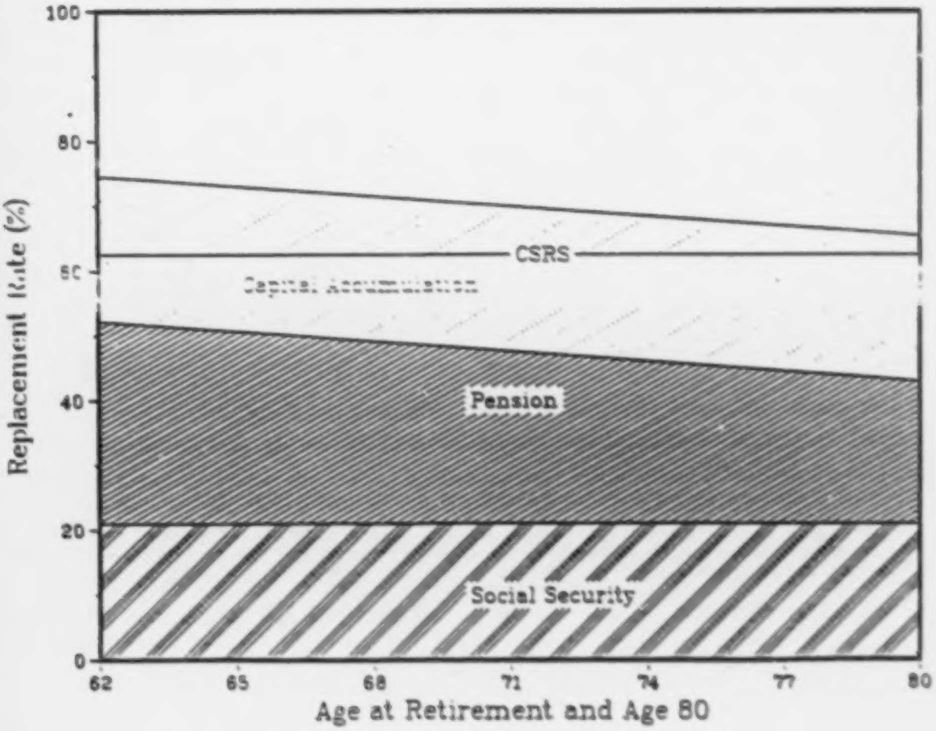


FIGURE 3. Benefit Value at Retirement with Different Amounts of Service

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 62
Service: Varies
Salary: $30,000 (adjusted to 1985 levels)

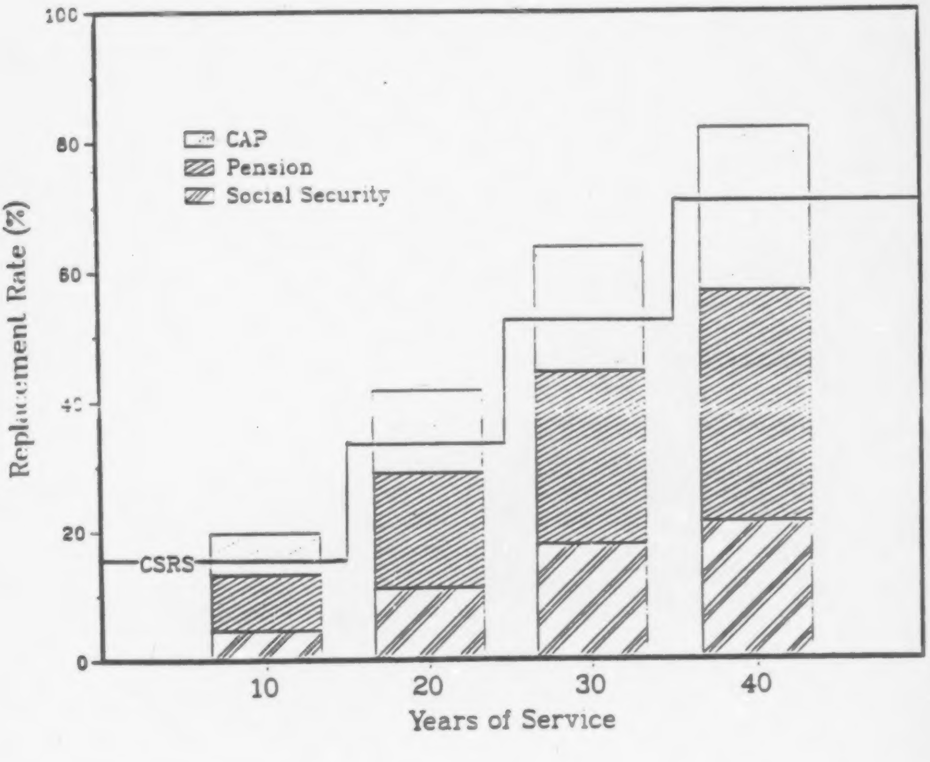


FIGURE 4. Benefit Value at Retirement for Workers with Different Ages

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: Varies
Service: 30 years
Salary: $30,000 (adjusted to 1985 levels)

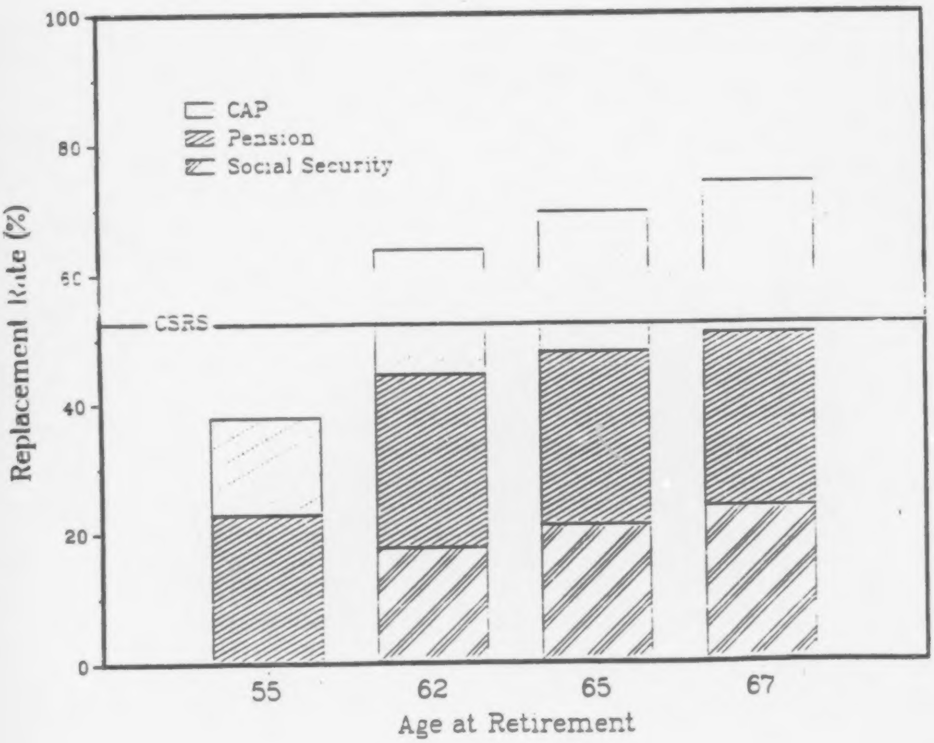


FIGURE 5. Benefit Value at Retirement for Workers with Different Salaries

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 55
Service: 30 years
Salary: Varies

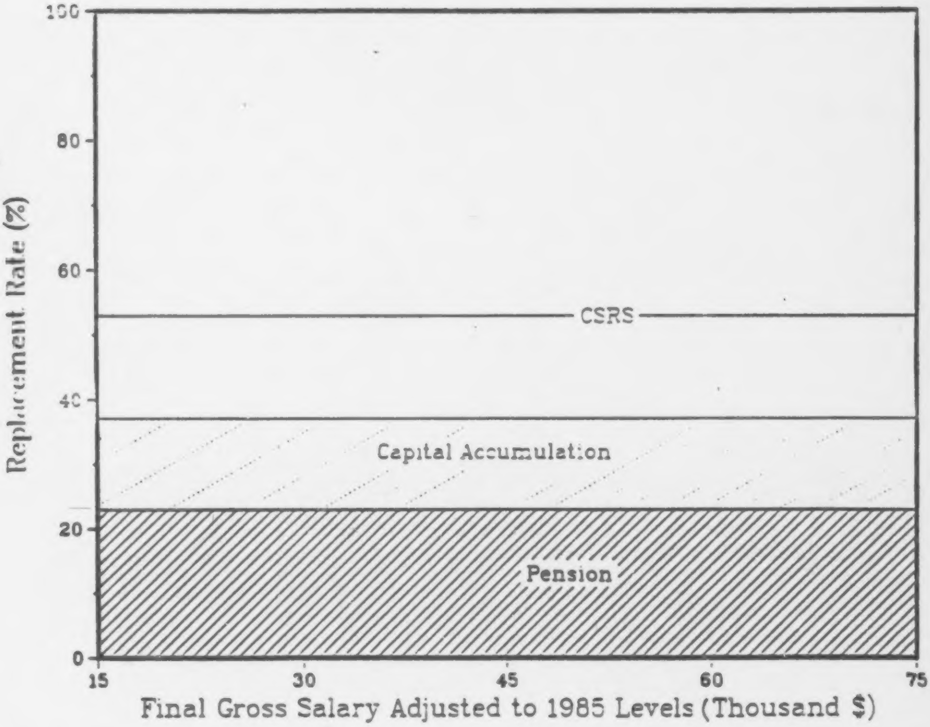


FIGURE 6. Benefit Value at Retirement for Workers with Different Salaries

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 62
Service: 10 years
Salary: Varies

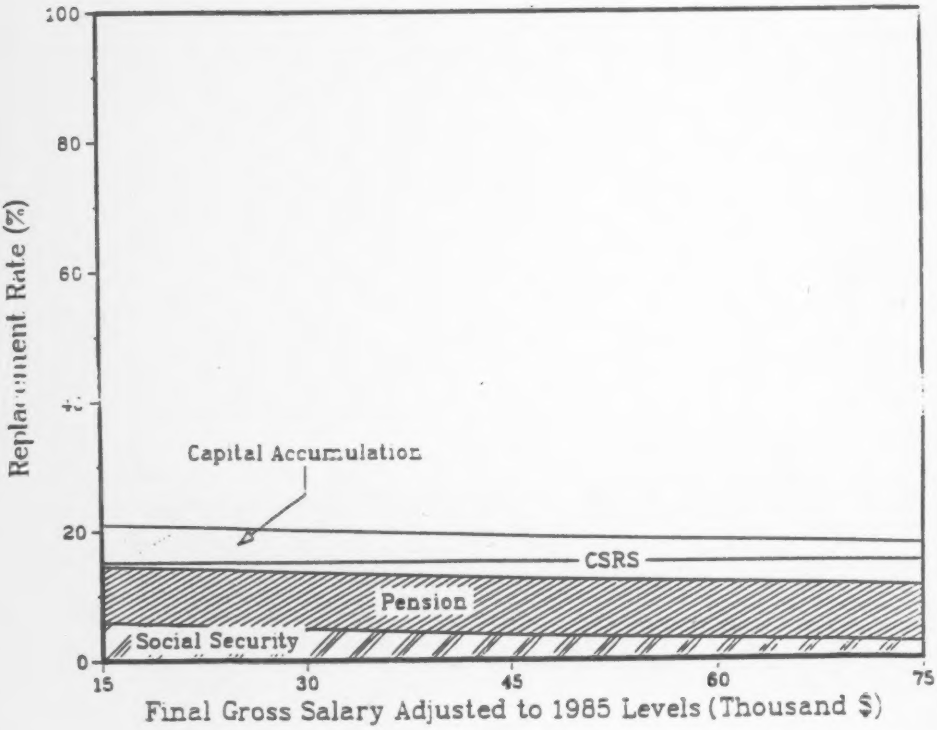


FIGURE 7. Benefit Value at Retirement for Workers with Different Salaries

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 62
Service: 20 years
Salary: Varies

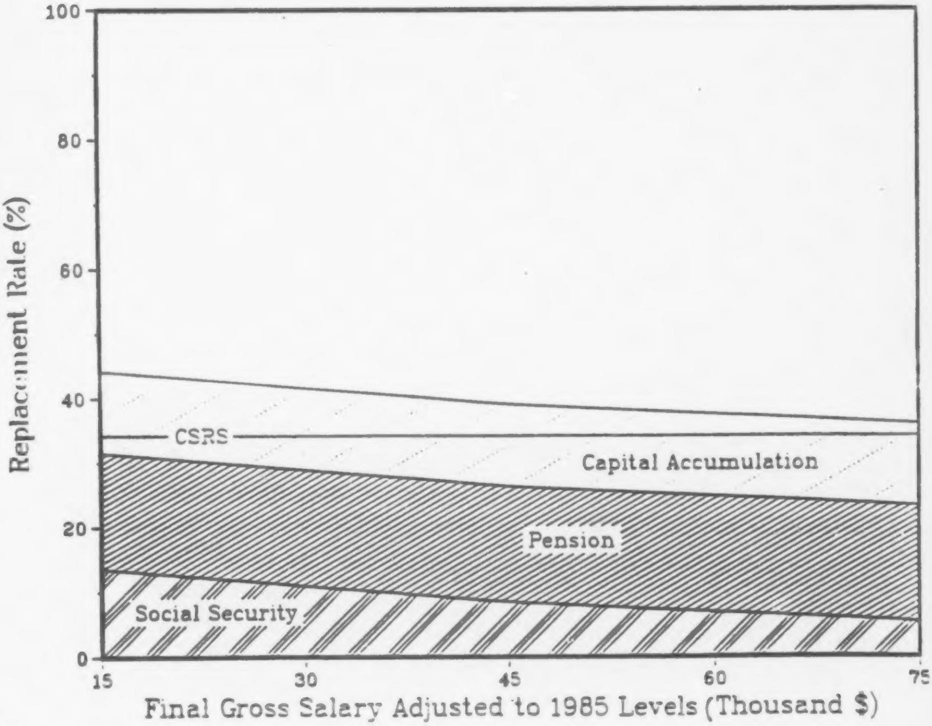


FIGURE 8. Benefit Value at Retirement for Workers with Different Salaries

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 62
Service: 30 years
Salary: Varies

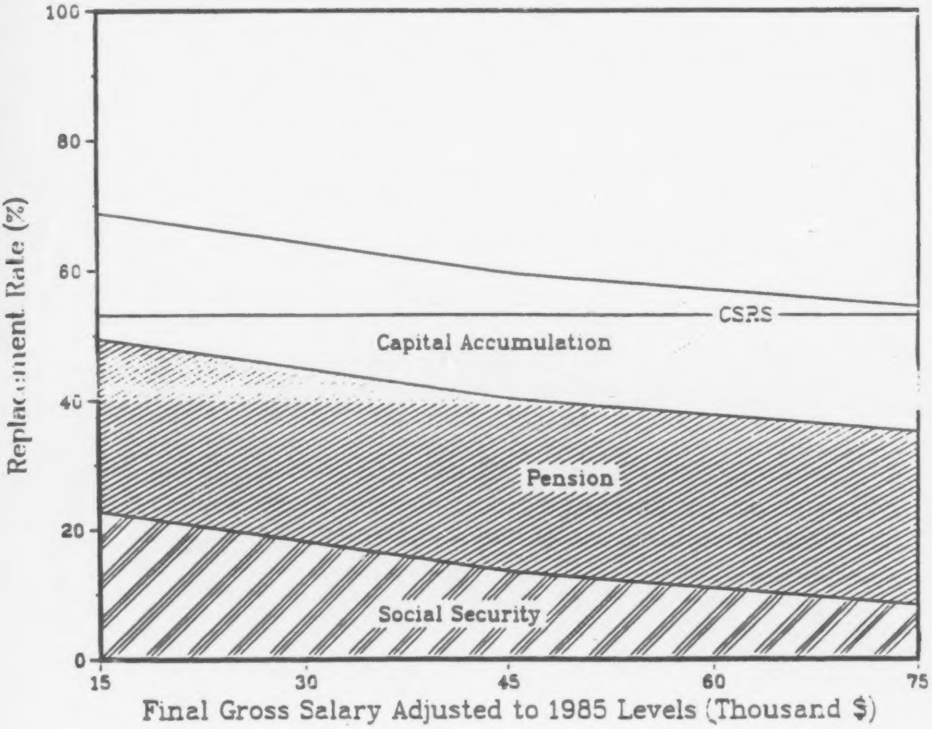


FIGURE 9. Benefit Value at Retirement for Workers with Different Salaries

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 62
Service: 35 years
Salary: Varies

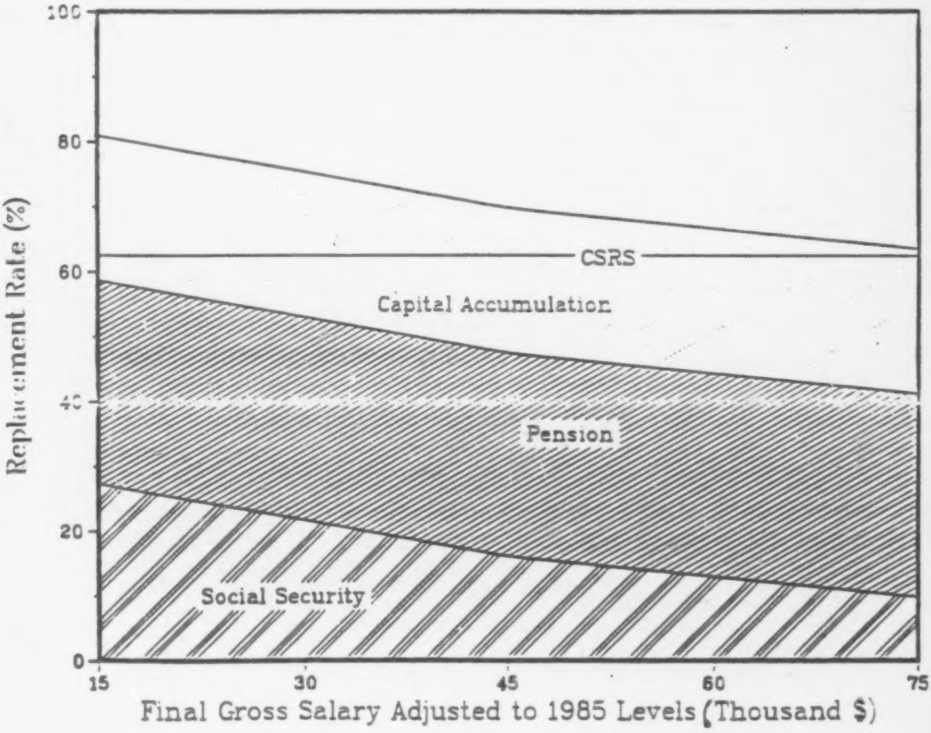
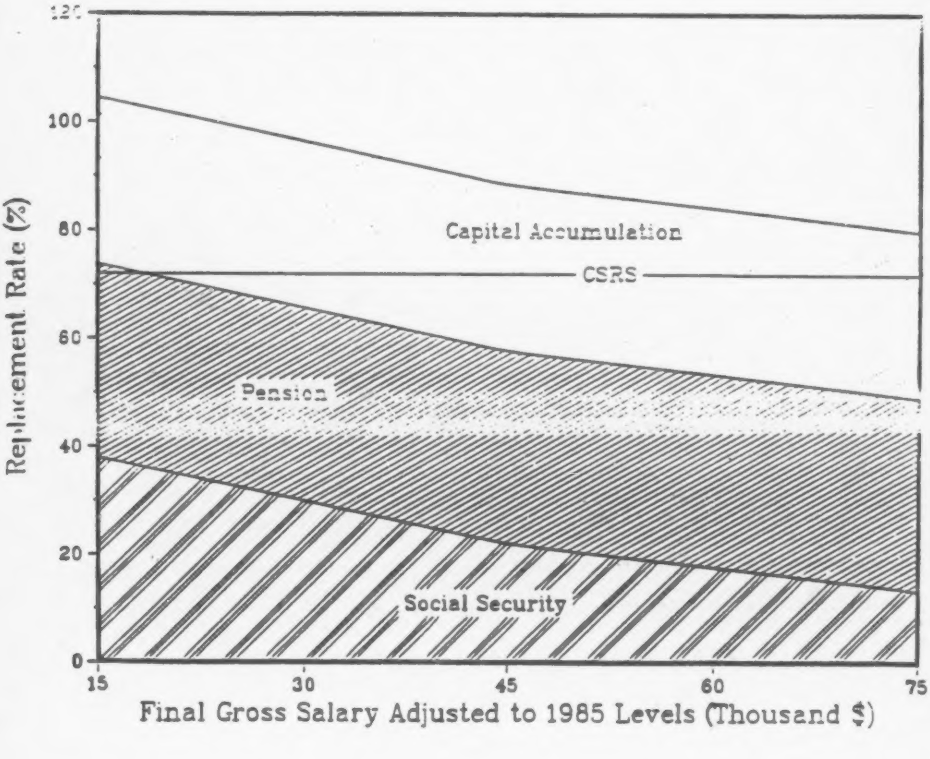


FIGURE 10. Benefit Value at Retirement for Workers with Different Salaries

Gross Replacement Rates
Worker Retiring in the Year 2030

Age: 67
Service: 40 years
Salary: Varies



V. METHODOLOGICAL SUPPORT

A. Cost and Replacement Rate Models

The estimates of retirement costs and benefits presented in this analysis were generated using the Congressional Research Service's cost and replacement rate models. These computer-based actuarial models were developed by CRS with actuarial support and a Pension Valuation Language (PVL) provided under contract by Hay-Huggins, Inc., an actuarial consulting firm. It should be noted that these models project future outcomes from assumptions. While such projections are valuable tools for making relative cost and benefit comparisons, it is inappropriate to imply or to seek a degree of accuracy for them that is in principle unattainable.

1. Cost Model

The cost model projects long-term costs of pension designs. The approach used is known as "entry age normal cost," and can be generally understood as the percentage of every paycheck that should be invested, over the total career of each employee in a group of new entrants, to pay fully for all benefits received by that group, including all eligible survivors. Normal cost is formally defined as the present value of future benefits divided by the present value of future compensation. These values are expressed as a percentage of payroll, and provide a consistent measure of relative pension costs over time.

2. Replacement Rate Model

The replacement rate model projects the percentage of gross preretirement wages replaced by gross postretirement benefits. This percentage can be shown at retirement and at various ages after retirement, with the latter expressed in values relative to purchasing power at retirement. Capital accumulation replacement rates assume the purchase of an annuity indexed to the assumed rate of inflation.

B. Data and Assumptions

The cost and replacement rate models required the use of certain data and assumptions, in order to project cost and benefit outcomes for employees entering work in 1985 and retiring in the year 2030. A profile of the Federal workforce into the future was drawn from data of the current system, and other factors pertaining to costs and benefits were identified and assumptions about the relative weight of those factors were made. Complete documentation of the methodology, data and basis for all assumptions is available from CRS.

1. Demographic Assumptions

Given the order of magnitude of Federal employment, fairly reliable data on the Federal workforce could be obtained, and was used whenever appropriate. The vast majority of the data used to construct a demographic profile of the Federal workforce was provided by the Office of Personnel Management (OPM). These data included career patterns, mortality and disability rates, probability of leaving a surviving dependent, etc. Certain modifications were made to the OPM data that lessen the growth over time in the patterns of career improvement, and social security estimations of future improvements in mortality were also incorporated.

2. Economic Assumptions

All economic assumptions were taken from the 1985 Social Security Trustees' Report under the designation, "Intermediate II-B." The II-B assumptions are most commonly accepted as being neither optimistic nor pessimistic. When the 1986 Trustees' report is issued, CRS will incorporate any changes to II-B into the cost and replacement rate models. For 1985, the assumptions were annual average increases of: Interest, 6.1 percent; wages, 5.5 percent; and prices, 4.0 percent.

3. Behavioral Assumptions

Changes in plan designs relative to one another will cause changes in behavior which in turn affect plan costs. The changes in assumed rates of retirement, separation, etc., were made by the actuarial consultant, after research and discussions with CRS staff.

4. The Cost of Social Security

Generally, the cost of social security to its participants is the same as the tax that must be paid to the program. For these estimates, the cost of social security is the ratio of social security (OASDI) taxes to total Federal payroll over the 75-year period of the projection, evenly divided between employees and the Federal Government as employer. Under social security II-B assumptions, the benefits and taxes of the program are roughly in balance over that period, if the tax on social security benefits is treated as a revenue to the program. It should be noted, however, that some of the social security taxes on Federal payroll are not received back by Federal workers in the form of benefits because the average of Federal wages covered by social security exceeds the average covered wage in employment outside the Federal Government. Because the social security formula enhances the benefits of lower-paid workers, approximately 0.4 percent of payroll of the tax credited to social security from Federal wages is redistributed to workers outside the Federal Government. If the Federal Government is viewed, not as an employer, but in its other role as participant in the national economy, this redistributed amount could be construed as a savings.

Other differences in the pattern of payments between the present CSRS and social security are also taken into consideration when costs or replacement ment rates for a new plan incorporating social security are compared to the current system. The value of this difference is approximately two percent of payroll. About two-thirds of the difference is attributable to the portable rights to social security earnings credits retained by employees who leave employment with less than a full career. The remainder of the difference, after certain offsets and overlaps are netted, is attributable to dependents' benefits payable under social security but not payable from the current CSRS. The sum of these differences in the pattern of payments has been distributed across the various benefit components of the proposal and is thus reflected in lower replacement rates at retirement (excluding benefits from capital accumulation) of about five percent of total benefits attributable to the employer share of total plan costs.

5. Estimated Capital Accumulation Costs

Cost of the capital accumulation plans analyzed by CRS depend on the participation rate of individuals. Such rates, expressed as "percent of full participation," are influenced by two features of the plan: The rate at which employee payments to the capital accumulation plan are matched by employer payments, and the ceiling on employee contributions eligible for such matching dollars. Some employees will contribute the full amounts permitted by the plan specifications, others only some, still others not at all. The percent of full participation is the net average of full participation after all full, partial, and zero contributions have been combined.

The cost to the Federal Government of the capital accumulation plans is established by multiplying the matching rate specified for the plan by the estimated percent of full participation. For example, Hay-Huggins, Inc., estimated that a plan with a 50 percent employer match of employee contributions to 6 percent of pay would acquire a 55 percent average full participation. Multiplying that rate times the maximum government match (three percent) yields a Federal Government cost for the plan of 1.65 percent of pay.

This proposal includes a capital accumulation plan that permits the employees to contribute as much as 10 percent of their salaries, with the first 5 percent matched on a one for one basis. Hay-Huggins estimates that the phased vesting of 25 percent of the matching amount for years two through five would reduce the cost to the government approximately 0.03 percent, as employees who separated with less than five years of service lose portions of the matching amount. Thus, at a 60 percent rate of full participation, employees would contribute an average of approximately 3.0 percent of salary, and the Federal Government's matching cost would be approximately 3.0 percent of pay. Documentation of the method for arriving at the variable used for the capital accumulation cost assumptions is available from CRS.

Civil Service Pension Reform Act of 1985 (S.1527)

Explanation of legislation introduced July 30, 1985

Background

The Social Security Amendments of 1983 (Public Law 98-21, April 20, 1983) provided for social security coverage of federal civilian employees who were hired January 1, 1984 and after. This ended discussions over many years about the pros and cons of bringing federal employees into social security. But it also started the lengthy process of designing and installing a new program of federal employee benefits to supplement the retirement, survivors and disability benefits provided by social security.

The current Civil Service Retirement System (CSRS), one of the nation's earliest formal pension programs, began in 1920, more than a decade before the social security program got its start. Historically, the CSRS benefits were designed to be adequate on their own, without using social security benefits as a base. The same was true of federal employee benefits payable after an employee's death or disability--social security was not counted as a source of these benefits.

Because the existing CSRS program was not intended to supplement social security, a new program is needed for newly hired employees who are under social security. Accordingly, the 1983 law also mandated that such a new program be designed and adopted by the end of 1985, with an interim plan in effect during 1984-85. Under these provisions, if a supplemental plan is not adopted by January 1, 1986, at that time the newly hired employees will be required to pay a total of 14% of their salary to the old civil service retirement plan and social security. Clearly, such a result would be inappropriate, with both employer and employees bearing a heavy burden of costs for unnecessary and overlapping benefits.

This new legislation responds to this problem by providing a new retirement program for federal workers that supplements social security. It borrows many features and ideas that have evolved in recent years among employers outside the federal government who have had to coordinate their employee benefit plans with social security. It gives to employees important new options that will provide greater career flexibility. It replaces outdated provisions that have added to costs unnecessarily. In brief, it takes full advantage of the opportunity to restructure benefits to meet the needs of the federal work force of today and tomorrow, using a cost-effective design that makes good use of the government's limited resources.

The new plan has three principal components -- (1) social security, which provides old-age, survivors and disability benefits for workers and their families; (2) a basic pension

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This explanation of the bill was prepared by staff of the Senate Committee on Governmental Affairs in August, 1985.

plan, with the full cost paid by the government; and (3) a thrift-savings plan, which allows employees to invest for retirement in the private sector on a tax-favored basis. The new plan has many other features, including benefits payable after the employee dies or becomes disabled, deferred vested benefits payable to those who leave federal employment in mid-career, and a transfer provision that allows existing employees to join the new plan.

Component 1: Social Security

An employee earning $30,000 a year and retiring at age 62 after working a full career under social security would get a retirement benefit from social security of 21 percent of pay, or 31 percent if the employee had a nonworking spouse, and with full cost-of-living adjustments (COLAs) after retirement.

These benefit percentages are based on the formulas which apply to young workers currently entering the work force. They reflect a normal retirement age of 67 under the social security program, and a 30-percent reduction in benefits for retirement at age 62.

Higher-paid employees get proportionately less from social security--for example, a single employee earning $60,000 would get 12 percent of pay. This decrease in the benefit percentage as pay goes up is called the social security tilt.

Social security also pays benefits to workers and their families in case of disability or death. Disability benefits are paid from social security if the worker is unable to work at any job, with a less strict test used during periods of rehabilitation. Survivors benefits are payable from social security to a deceased worker's surviving spouse who is over age 60 (age 50 if disabled), or who is under 60 and caring for one or more children under age 16. Children's benefits are payable to children under age 18.

Component 2: Basic Pension Plan

Unreduced Benefits

The basic pension in the new plan is 1 percent of "high-5" average salary times the number of years service. Salaries for this purpose are averaged over the employee's five highest consecutive years. The basic pension amount is payable without reduction to employees retiring at age 62 with at least 5 years of service. According to a report issued by the General Accounting Office to the Senate Committee on Governmental Affairs in June 1984, age 62 is the most common age for the receipt of unreduced retirement benefits under private pension plans. The report also indicated that a high-5 salary formula is the method most often used to compute average salary for pension purposes. The full cost of this basic pension is paid by the government.

This basic pension assures that all career federal employees will earn enough retirement benefits to have a reasonable supplement to social security when it becomes available at age 62. In addition to the basic pension, the employee then has the option of contributing to the thrift plan to accumulate larger benefits or to retire earlier.

The flat 1%-per-year formula does not reduce the tilt in total benefits caused by social security, as described earlier. Hence, lower-paid employees will get proportionately more than higher-paid employees from the combination of social security and basic pension. This flat kind of pension formula is called an "add-on". In contrast, an "integrated" type of pension formula would explicitly reduce the social security tilt.

The new plan uses an implicit form of integration with social security through the thrift-savings plan. Due to the social security tilt, employees at lower pay levels get reasonably adequate benefits from social security and the pension plan, with little or no need to contribute to the thrift plan. Lower-paid employees can elect to divert less of their pay into the thrift plan, and get more current take-home pay. Higher-paid employees with greater disposable income can utilize the savings plan to accumulate retirement benefits that provide the same percentage of pre-retirement earnings. The tax deferral nature of such contributions makes such savings more attractive.

Cost-of-living adjustment (COLA)

The basic pension has an annual cost-of-living adjustment (COLA) that increases the amount of benefit paid in proportion to the percentage increase in the Consumer Price Index (CPI) minus 2 percentage points. Thus, if inflation in a given year were 8 percent, pensions would go up by 6 percent. This COLA is intended to provide reasonable protection against inflation, recognizing that the employee also gets a social security benefit with a full COLA.

Normal practice in the private sector is to increase pensions being paid by only a fraction of the rate of inflation, up to about one-half of the full rate of inflation. Such increases are provided on an ad-hoc basis, lagging behind inflation and relying on the employer to remain in business for many years to pass along to current customers the additional cost of the increases. Thus, the automatic COLA in this new plan for federal employees provides a much greater degree of protection against inflation than private firms provide. Employees wishing to have even more protection are able to save additional amounts for this purpose under the thrift-savings plan.

Reduced Benefits at Early Retirement

The legislation breaks important new ground by giving federal workers the option to retire early with reduced benefits--as early as age 55 with 10 years service. Little or no additional long-range cost is required, because benefits are reduced 5 percent for each year that retirement age is below age 62. For example, an employee age 55 with an unreduced pension of $1,000 a month would take a reduction of 35% (5% times 7 years), and so could elect to take a reduced pension of $650. The additional cost of paying pensions earlier is approximately balanced by the 5%-per-year lifetime reductions. For employees with 30 years of service or more, the reduction is 2% per year below age 62.

Employees, and under the new plan former employees, with vested deferred pensions may tailor this early retirement option to fit their personal career or family plans. For example, an employee can opt for early retirement if he wishes to start a second career or the employee's spouse is planning to retire. No longer will federal employees feel locked into their jobs by an "all-or-nothing" retirement plan that does not provide partial benefits for those who wish or need to retire early. This reduced-pension feature is very common among private plans, and is long overdue for federal civil servants.

Vested Deferred Pensions

After 5 years of service, employees become fully vested in basic pensions based on their service to date. Thus, employees who leave federal government service after 5 years retain the right to receive a deferred pension payable in full at age 62, or in a reduced amount at age 55 if they have at least 10 years service. The usual early retirement reduction formulas apply in such cases, based on the number of years before age 62 that pension payments begin. Hence early retirement benefits to employees with 10 years of service, but less than 30 years, are reduced by 5 percent times this number of years; if service is 30 years or more, the benefits are reduced by 2 percent per year that retirement age is before age 62. This is the usual approach in private industry, which avoids additional long-range costs by reducing benefits appropriately at early retirement. A different approach is used in the current federal retirement system, in which a terminated vested employee cannot receive deferred retirement benefits before reaching age 62.

Optional Methods of Receiving Pensions

The standard payment method for the basic pension is an annuity over the lifetime of the retired employee, payable in a constant amount adjusted only by the COLA. Employees may instead elect to have the pension paid in a different way that is more appropriate to their individual circumstances. The new plan requires that employees be offered a choice including at least two optional forms of pensions, (1) a joint-and-survivor form, which provides for payments to an eligible survivor after the employee's death, and (2) a social security leveling option, which increases payments at ages 55 to 62, and reduces them after age 62, so that the total amount including social security received each month is approximately the same before and after social security begins at age 62.

Pensions will be paid to a married employee using the joint-and-survivor method unless both the employee and spouse reject that method in writing. The standard joint-and-survivor method provides for payment of a joint pension in a reduced amount during the years both employee and spouse are alive. Then if the spouse survives the employee, payments at 50% of the joint pension amount continue to the spouse for life. If the employee outlives the spouse, payments to the surviving employee are made in the unreduced amount.

For example, suppose a married employee with a spouse the same age were retiring with a pension of $1,000 a month, before electing a 50% joint-and-survivor option. In this case the reduction factor would be approximately 10 percent, so that $900 would be paid each month as long as both were alive. Then, if the spouse outlived the employee, payments would continue to the surviving spouse at $450 a month (one-half of the $900). If the employee outlived the spouse, payments would continue to the surviving employee at $1,000 a month (the unreduced amount). As long as the options are actuarial equivalents, they do not create any extra long-range cost to the plan. Thus, in the example above, the reduction of $100 a month during the joint lifetimes pays for the expected cost of the additional benefit of $450 a month to the surviving spouse.

Under the present CSRS, a joint-and-survivor option requires that the employee's pension be reduced by 10 percent, except that the first $3,600 of pension takes a reduction of only 2.5 percent. This is known as a subsidized option, which creates additional cost. It may be justified under a plan such as CSRS, whose participants do not earn part of their pensions from social security. The rationale is that social security includes an automatic benefit for spouses and surviving spouses, without any reduction in the worker's benefit. Thus a subsidized option under CSRS tends to substitute for the automatic social security benefit. Because participants in the new plan are also covered by social security, this rationale does not exist and the actuarial-equivalent reduction percentages are entirely appropriate.

An employee electing a joint-and-survivor method may also name some other person besides the spouse to receive survivor payments, if the other person has an insurable interest in the employee's life, such as a dependent child or other family member.

Special provisions for former spouses are also included which parallel the provisions of the CSRS. In general these provisions recognize that a former spouse may have higher priority to benefits than a current spouse, within the scope of applicable court orders and legal agreements.

Component 3: Thrift-Savings Plan

Contributions by Employer and Employees

Employees may elect to participate in the thrift-savings plan by contributing up to 10 percent of their pay. This plan is entirely optional, and employees can change their contribution amounts at least annually. Employees who become disabled remain eligible in the same way as active employees, with the 10-percent limit applying to their disability income from the new plan.

The government will match the employee's contributions, up to 5 percent of pay, dollar-for-dollar. The contributions for each employee go into a thrift plan account which is held and invested for that employee as part of the plan's funds.

The new plan provides for tax-deferral of employee contributions, in the same general manner that has long been available to employees of private firms, tax-exempt nonprofit organizations and state-local government under various provisions of the Internal Revenue Code. Employee contributions to the thrift plan are excluded from current taxable income at the time they are paid into the plan. Social security payroll taxes still are paid on the gross salary before deducting employee contributions, the same treatment as in the arrangements available to employees outside the federal government.

Thrift Plan Investments

The thrift plan money can be invested in the private sector with certain limitations. Historically, rates of return on government bonds have been below the rates available on other securities. Because the rates of return on thrift plan funds will affect the retirement benefits that these funds can provide, employees are given the opportunity to invest their thrift plan funds outside the government. Employees may elect each year how they want their accounts to be invested. An employee may select one or more of three funds established under the plan, subject to certain limits during the plan's first ten years (1987 through

1996.) These options are patterned after the most popular ones found in thrift plans in private industry.

Fund A consists of U.S. government securities in the form of special 2-year notes bearing interest at the average rate of other 2-year government notes. This provides maximum security along with a good return.

Fund B is a fixed-income fund, invested in Guaranteed Investment Contracts (GICs) issued by insurance companies, or in other instruments such as bank certificates of deposit. These instruments would not be government insured but rather would be contractually guaranteed through the issuing company. In recent years GICs have become a highly popular form of investment for all kinds of pension plans, especially among employees participating in thrift plans.

Fund C is an index fund invested in common stocks. This means that a well-diversified portfolio of common stocks will be selected and used as the model for Fund C, such as the Standard & Poor's 500 Stock Index. All the money in Fund C will then be invested in the same stocks that make up the index, and in the same proportions. This method of investment is also very popular among private plans, especially pension plans and to a lesser extent thrift plans (where employer stock is more commonly used, a choice not open here).

An index fund has several advantages for the new plan as a way of investing in common stocks. An index fund is inexpensive and cost-effective. It provides a return equal to the market average with the index itself determining how the fund will be invested. An index fund is diversified, avoiding large holdings of any one stock that could lead to undue risk or potential control of the issuing corporation. Index funds have performed well as a type of investment, especially in recent years. This type of investment is largely self-managing, requiring very little administrative overhead. This self-management approach also avoids possible pitfalls and conflicts of interest that could arise from federal government involvement in private investment decisions, because such decisions will be made by the marketplace and not by government officials.

To reduce the administrative and financial impact of the new plan, during its early years certain minimum percentages of the employee and employer contributions are required to be invested in government securities using Fund A, as follows:

Contributions in calendar year	Percentage of employee contributions	Percentage of employer contributions
1986	N.A.	N.A.
1987	100	100
1988	80	100
1989	60	100
1990	40	100
1991	20	100
1992	0	100
1993	0	80
1994	0	60
1995	0	40
1996	0	20

The funds required to be invested in Fund A from each employee's account to meet these limits may not later be moved to one of the other funds.

Vesting and Payout of Thrift Plan Accounts

The employee contributions, and investment return attributable to these contributions, are fully vested at all times, and can be taken out by employees who leave the government as described below. Employer contributions become vested at the rate of 20 percent for each year of service, so that employees with 5 or more years of service are fully vested in the employer contributions and investment return attributable to them. At the employee's death, employer contributions become fully vested and available to the employee's named beneficiary or estate.

No payments are permitted to active employees, except in accordance with a program of hardship loans that is to be established by January 1, 1988. Employees who leave the government have several options about how the vested amounts held in their thrift plan accounts are paid. Employees who are eligible to retire under the basic pension plan may elect to receive their thrift plan funds in a lump-sum cash payment, or may convert them to an annuity or roll them over to an individual retirement account (IRA). Employees who terminate employment prior to retirement may leave their funds in the thrift plan or may roll them into an IRA.

The legislation also specifies how survivor benefits may be payable from an employee's thrift plan account to a surviving spouse or former spouse.

Investment Policy

It is expected that under current conditions the assets of Fund B will consist of debt instruments issued directly by secure financial institutions or other private borrowers with sound credit ratings, or selected by qualified investment advisors, so that those who manage the plan's investments are not directing this money into specific uses.

Fund C is inherently self-managing because of the index approach, and can best use a widely recognized index for which market values are published regularly in the financial pages.

The thrift plan provides for possible additional funds beyond the original Funds A, B C, to take advantage of opportunities that may emerge.

Because the thrift plan requires broad acceptance by the employees and the public, all of the funds must operate in a way that allows private financial markets to maintain their stability and objectivity.

Thrift Plan Administration

The thrift plan is to be administered by a 5-member board. Three of these members are high government officials--the Secretary of the Treasury, Director of the Office of Personnel Management (OPM) and Chairman of the Federal Reserve Board, acting as chairman of the thrift plan board. The other two members are appointed by the President from federal employee organizations, with one of these organizations representing employees who are managers and one representing labor. The board operates through an executive director and staff, with support from outside contractors and OPM as required.

The board also is assisted by an advisory committee, whose 6 members all have full-time responsibilities as asset managers or administrators for thrift plans outside the government. This advisory committee is expected to play an important part in establishing and maintaining the thrift plan administration.

The thrift plan administration entails several new responsibilities for the federal government, for which private plans have developed a body of experience and precedents in recent years. The biggest such responsibility is computerized recordkeeping for the large and decentralized federal workforce, to produce individual statements at least annually showing each employee's thrift plan account balance and the amounts allocated to the different funds, and to provide for payments from the fund accurately and promptly. The thrift plan also requires good communications with employees about the options they have in designating annually how much to contribute and where funds will be invested, and in selecting one of the forms of payment available. The advisory committee is expected to be a source of guidance about using outside contractors for these tasks, and about providing up-to-date features in the plan without making the administration unduly complex and costly.

The thrift plan board members, and any others who manage or control assets of the plan, are subject to fiduciary standards patterned after those in the Employee Retirement Income Security Act of 1974 (ERISA). This includes a prudent-individual rule for managing and diversifying investments, a prohibition against self-dealing and a requirement that funds be used only to pay benefits and reasonable expenses for administration. There is a safeguard against potential conflicts of interest. In event of misdeeds by fiduciaries, the bill provides for personal liability, civil actions and other possible penalties.

A qualified public accountant will audit the thrift plan's books and records annually, including the participants' individual accounts, in the same manner as required under ERISA.

Survivors Benefits

Benefits at Death Before Retirement

The surviving spouse and family of employees who die before retirement may receive benefits from several sources, (1) social security survivors benefits, (2) payment of the employee's thrift plan account balance, (3) group life insurance proceeds from the Federal Group Life Insurance (FEGLI) plan, and (4) a surviving spouse annuity based on the employee's vested pension that is payable immediately or is deferred.

The legislation includes automatic coverage of federal employees by the basic FEGLI unit, with the government paying the full cost. Each unit provides life insurance equal to annual earnings plus $2,000, rounded to the next higher $1,000, times a factor of 1.0 for employees at age 45 and over. Below age 45, the multiplying factor grades up, to a maximum of 2.0 for employees at age 35 or under. At age 65, or retirement if later, the life insurance decreases by 2% a month until the multiplying factor reaches 0.25. Although most federal employees already contribute for basic group life, the intention is for some death benefit to be payable in all cases free of charge, even when no family member is entitled to a social security survivor benefit. Employees may also add to their coverage by subscribing to optional group life insurance.

Employees may also add to their coverage by subscribing to optional group life insurance.

The legislation includes benefits payable to surviving spouses of employees who die before retirement. At the death of an employee or former employee entitled to a deferred vested pension, the employee's spouse receives an annuity calculated as if the employee had terminated employment the day before and had elected a 50% joint-and-survivor annuity. This surviving spouse annuity begins immediately if the employee was eligible to retire at the date of death, or at the time the employee first would have become eligible to retire if later.

An annuity is also payable to a surviving former spouse if elected by the employee or annuitant under certain conditions, terminating at remarriage of the former spouse before age 55.

Disability Benefits

The legislation includes a long-term disability (LTD) plan with many features used by private firms. Employees are covered after 18 months of service, with benefits commencing after the employee's sick leave is used up. This LTD plan and social security provide adequate benefits to those who are truly disabled, while encouraging those who can return to work to do so. This is accomplished through the benefit levels and administrative structure. The LTD plan is administered separately from the pension plan by a third-party administrator to be selected from insurance companies or other firms outside the government.

Determination of Disability

Two alternative definitions of disability are used, with employees who meet the stricter definition getting benefits that are larger and are payable longer. The stricter "social security" definition requires that the individual be unable to do any job. The less strict "occupational" definition requires only that the individual be unable to do any job for which he or she is qualified, in the same federal agency, commuting area and grade level.

Employees claiming disability are examined by physicians assigned by the plan administrator. After benefits commence, disabled employees are subject to followup medical exams to verify that they remain disabled.

A further test of continuing disability is that the individual's earned income may not exceed 60 percent of the pay level of the job held at disability onset. An individual who earns more than this ceiling is removed from the disability rolls.

Disability Benefit Amounts

The basic disability benefit level is 60 percent of high-5 salary, payable until age 62 to employees who meet the social security definition of disability. Social security primary benefits payable to disabled workers are counted as a source of benefits under the program with the LTD payments supplementing social security as needed to bring total benefits up to the 60 percent level.

Benefits payable to disabled employees who meet only the occupational definition are reduced after the first year of benefit payments to 40 percent of high-5 salary. In such cases LTD payments stop at age 55 instead of age 62.

Annual cost-of-living adjustments (COLAs) are provided after LTD payments begin, consistent with the basic pension plan. The basic disability benefit level, 60 percent or 40 percent of the high five salary as the case may be, increases at the inflation rate less 2 percentage points with the LTD payment supplementing social security as needed to reach this basic benefit level.

Retirement Benefits after Disability

Disability benefits terminate when the employee reaches 62 (or age 55, if the individual meets only the occupational definition of disability). After that age, benefits are paid as retirement benefits, from a combination of social security, basic pension and the thrift-savings plan.

During the LTD benefit period the employee continues to have service credited, with years of disability counted as service. Also, during this time the employee's original average salary is adjusted annually at the rate of inflation less 2 percentage points for the purpose of determining the high-5 average salary that will later be used to compute basic pension benefits.

Upon reaching age 62 (or 55, as the case may be) the employee is eligible for a basic pension based on age, service and average pay at that time.

Other Provisions

Effective Date and Transition from Interim Plan

The effective date for most provisions is January 1, 1987. This allows some time for establishing administrative procedures.

Employees hired after 1983 now pay 1.3 percent of salary toward an interim federal retirement, survivors and disability program, in addition to social security payroll taxes, with matching payments by the employer. These payments are scheduled

Employees hired after 1983 now pay 1.3 percent of salary toward an interim federal retirement, survivors and disability program, in addition to social security payroll taxes, with matching payments by the employer. These payments are scheduled under current law to end on December 31, 1985, and under the legislation they continue through December 31, 1986. Thrift-savings plan accounts are established for each employee on January 1, 1987, and are credited with the employer-employee payments toward the interim program during 1984-86 plus interest.

Coverage of Employees and Service

Employees of the District of Columbia government are not eligible for the new plan if they were hired on or after January 1, 1987. Employees in any other groups currently covered by the interim plan enter the new plan on January 1, 1987.

Service for groups that are covered continues to be credited using the same procedures and definitions as under the current CSRS.

Special Classes of Employees

Special retirement-age rules apply to law enforcement officers, firefighters and air traffic controllers because of their physically demanding occupations. These classes of employees may retire with unreduced benefits at age 55 with 25 years of service. At that time they receive the basic pension, and a supplement from age 55 to 62 that is approximately equal to the social security benefit available at age 62.

These classes may retire before age 55 with reduced benefits if they have 25 years of service. The reduction is 5 percent for each year that retirement age is below 55. In such cases no supplement is payable before age 55.

National guard technicians are another special class because they must meet both the military and civilian standards. They may retire with an unreduced basic pension at age 55 with 30 years of service.

Other groups get the regular benefits of the plan.

Transfers of Current Employees

Individuals who are covered by the Civil Service Retirement System (CSRS) on January 1, 1987, may elect to join the new program within one year after that date, or within one year after rehire if they were out of federal service on January 1, 1987.

Transfers are generally prospective, so that benefits are credited under the old plan up to the date of transfer, and under the new plan thereafter. But to avoid loss of benefits due to the transition, several additional provisions apply.

First, the employee's salary after the transfer counts toward the average-salary computation under both the old and new plans. Thus, although crediting of service toward CSRS stops at the date of transfer, increases in the average salary under CSRS continue.

Second, service both before and after transfer counts toward the service required under either plan to retire, or to get deferred vested benefits.

Also, employees carry forward any survivor coverage they had at the date of transfer. Disability coverage from the old plan stops, and employees get credit for service before transfer toward the 18 months needed to become eligible for LTD benefits under the new plan.

Finally, employees who transfer are no longer subject to the social security windfall-benefit reduction rule in the 1983 law, or the public-pension offset rule applying to spouses as first enacted in the 1977 law.

Cost

The cost of a retirement plan is normally measured by the concept of normal cost, which is the amount necessary to fully fund benefits as a percent of gross payroll. Costs are further distinguished between those borne by the employer and the employee. The table on the following page summarizes the cost of the new plan and compares it with the current system as estimated by the Congressional Research Service. The employer normal cost of the current system is 25.0 percent of payroll. The comparable figure for the new plan is 20.8 percent, including social security and all other relevant benefits.

Cost Estimates for Senate Bill Introduced July 30, 1985,
and Comparison With Program Under Current Law

Based on Entry-Age-Normal Cost Method a/

	Current Program (baseline)				Senate Plan			
	Employer share	Employee share Required	Employee share Optional	Total	Employer share	Employee share Required	Employee share Optional	Total
Social security b/	---	---	---	---	5.9%	5.9%	---	11.8%
Basic Pension	25.0%	7.0%	---	32.0%	11.7	---	---	11.7
Thrift savings c/	---	---	---	---	3.0	---	3.0	6.0
Cost excluding FEGLI	25.0	7.0	---	32.0	20.6	5.9	3.0	29.5
FEGLI change d/	---	---	--	--	0.2	---	---	0.2
Full cost e/	25.0%	7.0%	N.A.	32.0%	20.8%	5.9%	3.0%	29.7%

a/ All cost figures are rounded to the nearest tenth of a percent. Administrative costs and benefits to special groups are excluded. Under the current CSRS these costs are estimated to be 0.1 and 0.3 percent of pay, respectively.

b/ Social security cost is the percentage of total Federal payroll taxable for social security (OASDI).

c/ Senate proposal provides for individual employee to elect contributions to thrift savings plan between 0 and 10% of pay. Based on assumed participation rates the average employee cost that is matched by the employer is assumed to be 3.0%, and the average employer cost is assumed to be 3.0% after deducting the sum of nonvested contributions forfeited (0.03%) by separating employees.

d/ Senate proposal would make basic Federal Employees Group Life Insurance (FEGLI) coverage automatic with employer paying full cost. Under current plan employee cost depends on whether coverage is elected, and can vary between 0 and approximately 0.2% for an individual. Based on current participation rates, the average employee cost is assumed to be 0.2%.

e/ Average full cost, including the average employee contribution that is matched and employer match to the capital accumulation plan, disregarding employee contributions that are not matched. Does not reflect additional cost of revenues due to tax deferral on thrift plan contributions by employees under Senate plan.

Source: Congressional Research Service

Replacement Rates

The adequacy of benefits is normally measured by the concept of replacement rates. This is the pension provided as a percent of final year's pay. The table and graph on the following pages show the replacement rates that would be achieved under the legislation for various employees at different income levels, as estimated by the Congressional Research Service.

REPLACEMENT RATES AT RETIREMENT

Employee retiring at age 62 with 35 years service

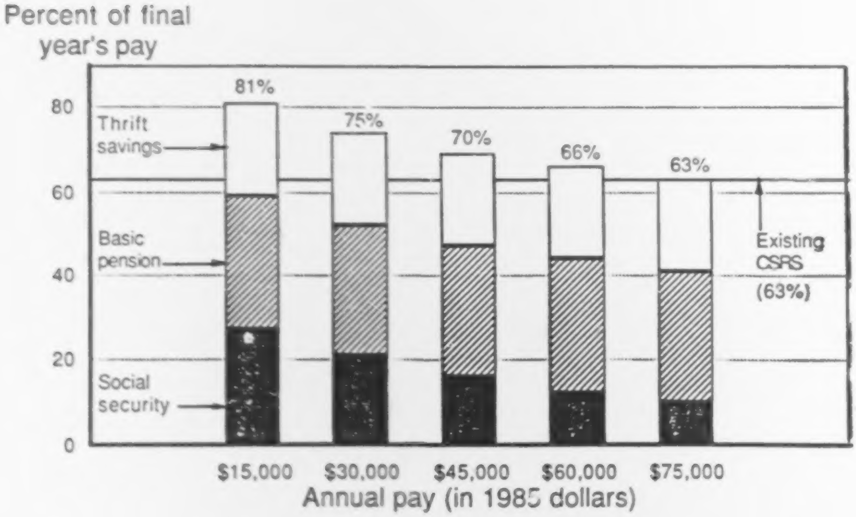
	Employee's annual salary				
	$15,000	$30,000	$45,000	$60,000	$75,000
Current CSRS..............	63%	63%	63%	63%	63%
Senate proposal--					
Employee not contributing to thrift plan:					
From social security......	27%	21%	16%	12%	10%
From basic pension........	31	31	31	31	31
Total from new plan.......	59%	52%	47%	44%	41%
Employee paying 5% of salary to thrift plan:					
From social security......	27%	21%	16%	12%	10%
From basic pension........	31	31	31	31	31
From thrift plan..........	22	22	22	22	22
Total from new plan.......	81%	75%	70%	66%	63%

Notes:
1. Replacement rate is the percentage of pay the employee receives from the retirement system, including social security and the thrift-savings plan under the new program.
2. Rates are for employees retiring in the year 2030, with salary figures adjusted to 1985 dollars.
3. Percentages are for the first year employee is retired, and are not adjusted for taxes or for inflation after retirement.
4. The thrift plan fund at retirement is assumed to be converted to an annuity with a full cost-of-living adjustment.
5. Social security spouse benefits are disregarded.
6. Economic assumptions include 4% annual rate of inflation, 5.5% pay increases and 6.1% interest.
7. Totals may not add due to rounding.

Source: Congressional Research Service

ILLUSTRATIVE REPLACEMENT RATES

Retirement at age 62 with 35 years service



Employee contributing 5 percent of pay to thrift-savings plan

Source: Congressional Research Service

CONGRESSMAN ROD CHANDLER

United States Senate

Committee on Governmental Affairs

Subcommittee on Civil Service,

Post Office and General Service

September 9, 1985

Thank you for allowing me to discuss with you what I consider a key element in our nation's future retirement programs. Clearly, the decisions made for Federal employees with respect to issues such as vesting, integration, retirement age and cost of living adjustments will greatly influence pension plans offered by competing employers in private and State and local government sectors. In designing a new plan, the needs of employees, the impact upon labor-management relations, recruitment and retention incentives and social policy implications must all be considered.

From hearings held by the Education and Labor Committee's Labor-Management Subcommittee, one area of consensus stands out: any National Retirement Income Policy should consist of the three-legged stool relying on social security, supplemental employer provided plans and individual retirement savings. The new Federal retirement system should recognize these elements and combine them in a manner to encourage recruitment and retention of competent employees.

Those who have studied the Nation's retirement systems stress that new policies should be set not by taking narrow, shortsighted approaches to retirement issues but by fully recognizing the impact that retirement decisions have on the economy as a whole and the implications that today's retirement decisions will have for decades ahead. Retirement policies should not create financial burdens which will become unacceptable and unsupportable by future workers, but instead should encourage savings, investment and productivity. This is necessary if our nation is to achieve non-inflationary economic growth and stablity.

In designing the Federal Annuity and Investment Reform Act of 1985, I have taken into consideration the viewpoints of others as to what elements should be included in a National Retirement Income Policy. I believe the FAIR program sets forth the necessary blueprint for building on the strengths and correcting the weaknesses of the present civilian Federal employee retirement system.

In order to make the new system comparable with pension practices of major employers of the private sector, a combination Defined Benefit and Defined Contribution plan is suggested. Unlike the present system and following the private sector practice, no mandatory contributions would be required by employees. To encourage the individual savings element of the three-legged stool, employees would be given an incentive to contribute on an after-tax (401(k)-like) basis to the Defined Contribution Federal Thrift Plan by matching employer contributions up to 3% of pay. With Social Security, the Defined Benefit and the voluntary Defined Contribution aspects taken into account, the so-called Social Security tilt would be addressed in a manner resulting in combined after-tax earnings replacement rates upon retirement which are roughly comparable at all federal earnings levels.

The retirement needs of our increasingly mobile population suggest that the federal system be made more flexible with regard to retirement age. Although comparability with the private sector suggests some reduction for each year a person retires under the system's normal retirement age, the availability of the Defined Contribution plan accumulations can supplement the Defined Benefit Plan early retirement benefits in a flexible manner.

I commend my Senate colleagues for their fine legislative approach to a new retirement program for civilian Federal employees. Because our intentions are very similiar, our proposals are similiar. Obviously we want to develop a plan that is comparable to a model private industry retirement plan, while providing good benefits and saving the government revenue over the long term.

There are, however, some differences in our approaches to a new plan. The Federal Annuity and Investment Reform Act would continue defined-benefit plan coverage using High-Three pay with a 1.2% accrual per year of service. This would allow new employees, as well as old employees who voluntarily elect into the new system, the convenience of being able to easily calculate their retirement benefits. This benefit formulation offers the least disruption to the current system and, thus, would be easily administered. Under my legislation, an agency would not be encouraged to discriminate in hiring a former or existing civil service employee over a new employee who never had previous federal service. This is because the FAIR approach minimizes any disparity between combined employee and employer contributions. Each agency would pay practically the same contribution for an old employee as for new employee. Thus transfering between agencies, as well as leaving government service and returning, would not be inhibited by artificial cost and administrative barriers. This flexibility would encourage better retention and recruitment of the highly qualified personnel we should demand of our federal managers.

The defined contribution plan would be a voluntary capital accumulation plan, in which an employee accumulates assets in a retirement savings account that can be converted to either a lump sum or an annuity when the employee retires. In the FAIR bill, a program of individual thrift retirement accounts (TRAs) would be set up for employee money voluntarily contributed, with federal funds added to encourage participation. Employees would be permitted to contribute up to 10% of their salaries to the plan, with the first 3% of pay matched dollar for dollar, by the employee's agency. If an employee elects to make contributions on an after-tax rather than a pre-tax basis, then the employee could have access to such contributions before retirement. If an employee separated from Federal service before becoming eligible to receive an annuity, the accumulated sums could be transferred to a new private sector group retirement plan called a Retirement-USA. The Retirement-USA concept is embodied in legislation which I've cosponsored in the House (H.R. 3098).

This particular aspect of the FAIR bill would be extremely attractive to employees. The individual would have control over his investments while having the added benefit of vast portability. While I understand the Roth-Stevens plan would have a graduated vesting feature, the Thrift Retirement Accounts under the FAIR bill would be immediately vested. Why? It is an attractive feature to employees at all income levels. It would avoid even the appearance of discriminating against lower paid workers since with 100% vesting and the dollar for dollar employer match, they will be encouraged to contribute even in early years. Similiar plans in the private sector have, I understand, achieved nearly universal participation. TRA's are also attractive to the employer because they would be easily administered. Current participants in the Civil Service Retirement System could participate in the Federal Thrift Plan although their contributions would not be matched by their employing agency.

To give recognition to portability, I believe we should continue with five-year vesting for the Defined Benefit plan and immediate vesting for the Defined Contribution plan. Consideration might also be given to allowing terminated employees with a few years of service to directly transfer the present value of their benefits under the Defined Benefit plan into the Defined Contribution plan. This would create additional funds for more mobile persons in the event of death and disability. The FAIR bill permits this for certain short-service employees.

Both the Roth-Stevens plan and the FAIR plan would increase the retirement age and reduce the cost-of-living adjustment. Obviously our objectives are the same, while our approaches are somewhat different. In the calculation of the COLA, the Consumer Price Index minus 2% approach would mean a relatively high percentage rate of payment in times of high inflation. With a flat rate percentage of the CPI used for the COLA, a more stable and predictable cost would result. The Congressional Research Service has completed its analysis of the FAIR legislation. I would be happy to provide copies for your information. CRS estimates that the cost of the FAIR plan to the Federal Government would be about 15% less then the current Civil Service Retirement System.

In summary, there appears to be a national consensus for retirement programs that provide security and protection against economic risks. There is also a consensus for tax incentives to encourage employer provision of retirement programs and individual savings. We are also critically aware of the problems presented by the present Civil Service Retirement System and our nation's $200 billion deficit. I am submitting for the record a copy of my statement in the Congressional Record on my bill, HR 2869.

Again I would commend the committee for addressing this difficult and urgent challenge. We are, of course, confronted with a statutory deadline. But of greater importance are the competing challenges of attracting and retaining the best workforce available to serve the American people, while holding the line on the cost to the federal Treasury.

FEDERAL ANNUITY AND INVESTMENT REFORM ACT, H.R. 2869, THE FAIR PROGRAM

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Washington [Mr. CHANDLER] is recognized for 5 minutes.

(Mr. CHANDLER asked and was given permission to revise and extend his remarks.)

Mr. CHANDLER. Mr. Speaker, today I am introducing a comprehensive legislative package to provide the framework for the needed debate on a national retirement income policy and, specifically, the application of such a policy in reforming the Federal civilian retirement programs.

Over the past few years numerous reports dealing with postretirement cost-of-living adjustments [COLA's] and Federal pensions generally have been issued by several Presidential commissions, the Congressional Budget Office, the General Accounting Office, the Congressional Research Service, and other study and research organizations outside Government. A repeated theme in these reports is the need to take a long-term comprehensive view—that is, the need for a rational and financially sound national retirement income policy. One of the key elements in bringing about such a policy is the extension of Social Security coverage to Federal workers. The cornerstone of this policy is now in place as a result of Congress having adopted via the 1983 Social Security amendments the recommendations of the National Commission on Social Security Reform to place all new Federal workers hired after 1983 under the protection of the Nation's basic retirement system.

In addition to universal Social Security coverage, the various studies have focussed on retirement income goals and benefit adequacy, retirement ages, equity—as between high and low wage workers, long and short service workers, men and women, Federal and non-Federal workers, and different occupational classes—disparities in disability programs, inflation and cost-of-living adjustments, strengthening individual retirement savings efforts, and the adequacy and affordability of program financing; for example, the policies needed to avoid imposing insecurity of future retirees and impossible funding burdens on future working generations.

Those who have studied the Nation's retirement systems stress that new policies should be set not by taking narrow, shortsighted approaches to retirement issues but by fully recognizing the impact that retirement decisions have on the economy as a whole and the implications that today's retirement decisions will have for the decades ahead. Retirement policies should not create financial burdens which will become unacceptable and unsupportable by future workers, but instead should encourage savings, investment, and productivity in a fiscally sound manner. This is necessary if our Nation is to achieve noninflationary economic growth and stability with respect to the various segments of the economy and their related institutions.

My legislation builds on the themes of the above-mentioned studies by taking a long-term approach in establishing a "fair" retirement income policy in connection with the Federal Retirement Program. The FAIR acronym stands for my Federal Annuity and Investment Reform Act of 1985. The FAIR Program sets forth the necessary blueprint for building on the strengths and correcting the weaknesses of the present system of providing retirement income for civilian Federal workers.

Generally the FAIR bill—establishes a defined benefit and voluntary thrift plan arrangement comparable to those found in the private sector to provide supplementary benefits for those Federal employees newly covered under Social Security, conforms the provisions of the CSRS and the new Federal thrift plan to the standards required under the Employee Retirement Income Security Act of 1974 [ERISA], extends the full protections and standards of the Employee Retirement Income Security Act of 1974 [ERISA] to the pension plan or plans established by the U.S. Postal Service for those employees newly covered under Social Security and excluded from coverage under the Civil Service Retirement System, and provides for Social Security coverage for current civil service employees who elect coverage under both Social Security and the revised provisions of the Civil Service Retirement and Disability System applicable to new employees.

In designing the provisions of the FAIR bill, I have taken into consideration the viewpoints of others as to what elements should be included in a "National Retirement Income Policy." The Education and Labor Committee and its Subcommittee on Labor-Management Relations, on which I serve, have recently completed hearings focusing on what business, organized labor, and employee groups think should be included in such a policy.

Clearly, the decisions made for Federal employees with respect to key issues such as vesting, integration, retirement age, and cost-of-living adjustments will greatly influence pension plans offered by competing employers in private and State and local governments sectors. In designing a new plan, the needs of the employees; the impact upon labor-management relations; recruitment and retention incentives; and social policy implications must all be considered.

From the Education and Labor Committee's hearings, one area of consensus stands out—that any National Retirement Income Policy should consist of the three-legged stool relying on Social Security, supplemental employer provided plans and individual retirement savings. Today more and more employers provide a combination of defined benefit and defined contribution plans. While ensuring consistency with the to-be-defined national retirement income policy, I believe we can also encourage individual savings. The FAIR Program recognizes these elements and combines them in a manner to encourage recruitment and retention of competent employees.

First, in order to make the new system comparable with pension practices of major employers of the private sector, a combination defined benefit and defined contribution plan is included.

Unlike under the present system and following the private sector practice, no mandatory employee contributions to the defined benefit plan would be required under FAIR. To encourage the individual savings element of the three-legged stool, employees would be given an incentive to contribute to the defined contribution "Federal thrift plan" through matching employer contributions. When Social Security, the defined benefit and the voluntary defined contribution benefits are taken into account, the so-called Social Security tilt will have been addressed in a manner resulting in combined after-tax earnings replacements rates upon retirement which are roughly comparable at all Federal earnings levels.

The retirement needs of our increasingly mobile population suggests the Federal system be made more flexible with regard to retirement age. Although FAIR provides more comparability with the private sector by including a reduction for each year a person retires under the system's normal retirement age, the availability of the Federal thrift plan accumulations can supplement the defined benefit plan in a flexible manner.

The testimony from congressional hearings is replete with reference to numerous invaluable studies and reports including those from the Congressional Research Service, the General Accounting Office, and the Office of Personnel Management. Most indicate the need for a system comparable with the private sector but which is also affordable.

Current Federal pensions are often the subject of criticism, mainly centered around the cost-of-living adjustment and early retirement. In comparison to the present system, the Congress should investigate ways to make the new system more comparable with private sector practices. Why? In order that the new system will survive the test of time. Not only must Federal employees be provided a sound pension plan, but the design must also be acceptable by the American taxpayer. With Social Security as the base and with needed revisions in both the early retirement and COLA provisions, I believe the design approach of the FAIR bill provides a plan that is attractive yet more affordable than the current system.

Consideration should also be given to providing increased portability of pensions for workers in both the Federal and private sectors. This is one issue which appears to have growing consensus for inclusion as an important element of a national retirement income policy. Throughout the Labor-Management Subcommittee hearings, frequent complaints were heard about the present situation in private and Federal plans where because of the mobility of the work force, "cashing out" of vast sums of pension assets results prior to retirement. These funds frequently are not reinvested for retirement purposes. Clearly, this is unfavorable both for the economy, which loses savings and captial formation, and for the individual who loses a future source of retirement income to supplement Social Security. The FAIR bill provides incentives for individuals to maintain their employee and employer contributions for retirement purposes and not use them for current consumption. On the other hand after-tax savings by employees are also encouraged so as to improve private sector capital formation and provide accumulated funds to meet other important employee financial needs.

To give further recognition to portability, FAIR continues the current 5-year vesting under the defined benefit plan and provides for immediate vesting under the new Federal thrift plan. Terminated employees with 10 or fewer years of service are given the option to directly transfer the present value of their benefits under the defined benefit plan into the Federal thrift plan. This would create additional funds for more mobile persons in the event of death or disability.

In the interest of honesty in govenmental accounting, FAIR also requires each Federal agency to recognize the normal cost of each employee's retirement benefits. The normal cost of the military retirement system is now recognized in this manner and there is no reason to do otherwise in other Federal systems.

The reports of the Universal Social Security Coverage Study Group, several Presidential commissions, and other groups that have studied pension and retirement issues over the past few years have suggested major changes in Federal retirement policies. With the inclusion of new Federal workers under Social Security beginning in 1984, it is now time to move forward to bring about a more rational and defensible retirement structure for Federal workers. Unless Congress acts in 1985 to enact FAIR, or a variant, Federal employees covered under Social Security will be required to increase their Civil Service contributions from 1.3 percent to the full 7 percent paid by old employees, thus reducing take-home pay by 14 percent—7 percent for Civil Service and 7 percent for Social Security, including Medicare.

As a supporter of the private pension system and ERISA standards, I believe much can be learned from the private system in constructing a reasonable and financially sound Federal retirement structure. It is from this background that I have developed this comprehensive legislative program, the Federal Annuity and Investment Reform Act or FAIR.

The purposes and objectives of FAIR are, to provide Federal employees with a Supplemental Staff Retirement Program coordinated with Social Security which is comparable to good retirement programs operated by major employers in the private and State and local government sectors in order: first, that the Federal Government will remain competitive with other employers with which it must compete for qualified employees, and second, that retirement program and Social Security benefits combined will provide a reasonable level of benefit adequacy at all preretirement income levels; to provide Federal employees with enhanced portability of retirement benefits which will permit greater flexibility in retirement planning and which will instill in the system a greater measure of equity as between short-service and long-service employees; to strengthen the financing of the Civil Service Retirement and Disability System by maintaining the one system for both old and new employees, by requiring full dynamic normal costs to be contributed on behalf of new employees as well as current employees, by requiring full employer contributions to amortize the initial unfunded liability over 40 years as a level percentage of payroll, and by providing the opportunity for enhanced investment earnings of the system; to encourage individual retirement savings and to promote flexibility in retirement planning by providing to all Federal employees access to individual thrift retirement accounts [TRA's] in which they have a free market choice of investment and in which there is 100 percent immediate vesting of employees contributions and for new employees employer matching contributions up to 3 percent of basic pay; to restore the defensibility of Federal employee retirement benefits and maintain the affordability of the Civil Service Retirement and Disability System by providing for a more rational benefit structure, particularly as it relates to early retirement and postretirement COLA's; to provide a revised retirement program structure which is not disruptive to the present system of providing benefits, which is relatively simple to administer, and which is easily understood by employees; and to provide for comparability between the retirement system features—taking into account Social Security, Civil Service retirement, and the new Federal thrift plan—for old and new employees with respect to contributions made by and beenfits received by such old and new employees, and the employer normal costs for all retirement and disability benefits computed on a dynamic basis for such old and new employees.

As a result of FAIR, an additional, direct benefit will accrue to the financial health of the Social Security old age, survivors, and disability trust funds. Since current employees may make an irrevocable election to come under both Social Security and the provisions of the CSRS and Federal thrift plan applicable to new employees, an additional employee and employer contribution of 5.7 percent of pay for each employee making the election will be made to the Social Security trust funds beginning in 1986. A high percentage of current employees can be expected to make the election on account of the following considerations—as under most private sector plans employees would not be required to make contributions to the defined benefit plan, so-called windfall Social Security reductions would be restored for current employees covered under the new system for 10 years or more, in most cases disability benefit levels would be increased, portability under Social Security would be available, the 3 percent employer matching contribution under the Federal thrift plan would be available, the new Social Security leveling option would be available, and the percentage of benefits already accrued would continue to apply to actual final pay.

In general, enactment of the FAIR Program will enhance the financial soundness of both the Social Security and Civil Service retirement trust funds and will instill into the system of Federal benefits new elements of equity, comparability, portability, and affordability.

Title I of FAIR establishes the Federal thrift plan. In designing a new supplemental retirement program for Federal employees newly covered under Social Security, both defined contribution and defined benefit approaches were considered—the present CSRS is of the defined benefit type. Neither approach standing alone was considered adequate to simultaneously meet the many objectives outlined above. In addition a defined benefit plan—if it is to meet ERISA standards—cannot, because of the redistributional aspects of Social Security, be devised to totally replicate current CSRS benefit replacement levels in every individual circumstance. A combination of both approaches, however, was found to provide the necessary mix of benefit adequacy, equity, flexibility, portability, and affordability.

The Federal thrift plan acting as a defined contribution supplement to Social Security and the basic defined benefit Civil Service Retirement arrangement provides: first, flexibility in retirement planning for example, funds for earlier retirement or COLA supplementation; second, individual incentive for savings and capital accumulation; third, a source of funds to meet auto, mortgage, educational and other major financial needs; fourth, individual employee choice in selecting investment and annuity programs offered by qualified financial institutions; and fifth, portability—through permitted rollover of employee contributions and employer distributions from the Civil Service and other pension plans, and the continued investment by the individual of thrift retirement account accumulations after the termination of Federal employment.

Title I of the FAIR Act adds new subchapter IV, sections 8361 through 8372 (the provisions of the Federal thrift plan) to title 5, United States Code.

Section 8361 provides for coverage and definitions.

The employees and officials in all branches and agencies of the Federal Government—including civilian, foreign, postal, judicial, congressional, and military service—are immediately eligible to participate on a voluntary basis in the Federal thrift plan [FTP]. The one exception to the general coverage rule excludes employees already covered under similar defined contribution plans; for example, employees participating in the defined contribution plans maintained by the Federal Reserve Board and the Smithsonian Institution.

Under the rules establishing the Federal thrift plan, plan participants may establish one or more thrift retirement accounts [TRA's] in a "qualified investment program" maintained by qualifying "pension asset managers." Optionally participants could direct their own contributions to the new "Federal fund" in which all employer contributions would also be invested.

Employees who participate in the Federal thrift plan by establishing and contributing to thrift retirement accounts [TRA's] during their working years continue, even after termination of Federal employment, to be considered plan participants who direct the investment in their TRA's. Upon the death of a participant who was maintaining one or more TRA's who was an active or separated employee, the designated beneficiary with respect to each TRA is given the same status as a participant who may elect to continue such TRA's and direct the investments in such accounts—or, in the alternative elect a lump-sum or survivor annuity.

The establishment of the Federal thrift plan is provided for under section 8362.

Section 8363 provides for contributions and transfers among TRA's.

Annual employee contributions: Employee participants may contribute up to 10 percent of basic pay each year to thrift retirement accounts of their choosing. Employing agencies would deduct from basic pay the amount or percentage of pay elected by the employee to be withheld and transmit such amounts to the TRA designated by the employee. Employees could change their TRA designation once a year—or more often if permitted by regulations. The first 3 percent of pay contributed by the employee would be treated as a "salary reduction"—automatically exclude from gross W-2 wages as under so-called 401(K) private sector plans. Contributions over 3 percent would also be treated as a salary reduction unless the employee elects to make "after-tax" contributions which would be allowed to be withdrawn prior to retirement.

Federal employer contributions: Each year the employing agency will match on a dollar for dollar basis and contribute to the Federal fund the actual amount of employee contributions made in such year, up to a maximum amount equal to 3 percent of the basic pay of such employee. Employees newly covered under Social Security—termed post-83 employees—and current employees electing post-83 status are eligible for matching employer contributions. Employees newly hired or employed after a break-in-service become eligible for matching employer contributions after completing 1 year of service. The employee has an immediate and fully vested interest in the amount of employer contributions made to his or her account.

"Rollovers" among TRA's: A plan participant while designating only one TRA at any one time to receive employee and employer contributions, may establish one or more additional TRA's and transfer some or all of the amounts in any TRA to any other TRA. For example, a participant might initially designate a particular "money fund" as the TRA to receive employee contributions and periodically transfer amounts in such an account to other TRA programs; for example, involving stocks, bonds, certificate of deposits, mortgages, annuities or other forms of investment offered by the same or another financial institution serving as a pension asset manager. From time to time the participant may wish to transfer funds—based solely on employee contributions previously made on an after-tax basis—to a TRA which allows the employee to make a withdrawal within the guidelines set forth under the Federal thrift plan for the purpose of meeting major financial expenses such as for a home loan, automobile, or education. At retirement the participant may wish to transfer his or her thrift retirement accumulations into a TRA offering a fixed or variable annuity.

While the terms of the Federal thrift plan do not restrict the number of TRA's a participant may maintain or the timing or frequency of transfers among a participant's accounts, the financial institution offering a TRA Program is not prohibited from establishing such restrictions or instituting penalties for early withdrawal or transfer.

"Rollovers" from other plans: Lump sum distributions to Federal thrift plan participants from other tax-qualified private or governmental pension, profit-sharing, thrift, et cetera, plans may be transferred and deposited to the credit of a TRA selected by the participant. If an employee who separates from Federal serfice elects to withdraw his or her accumulated employee contributions from the defined-benefit Civil Service Retirement and Disability System, the total amount of such accumulation is automatically transferred to a thrift retirement account of the employee's own choosing. The availability of these rollover provisions afford employees with a new means of pension portability and a deferral of taxes on such accumulations until later distributed.

Section 8364 provides for information to participants.

The board of the Federal thrift plan is required to prescribe regulations under which participants would be allowed to receive information about the particulars of thrift retirement programs offered by the various financial institutions in order that such persons may make informed investment choices among such programs.

Section 8365 provides for qualified investment programs.

In order for a TRA program offered by a "pension asset manager" to be eligible as a "Qualified Investment Program" under the Federal thrift plan, it must meet the following requirements. First, the program must be operated in accordance with the ERISA exclusive purpose rule of providing benefits to participants and beneficiaries and defraying reasonable administrative expenses.

Second, the program must meet any participant safeguards set forth in regulations, including the ERISA fiduciary standards requiring prudence and prohibiting self-dealing. The following fiduciary and enforcement provisions of ERISA are incorporated and made applicable to the Federal thrift plan by reference (sections 401(b), 404, 405, 406(b), 408, 409, 410, 413, 504, and 502 (a)(1)(B), (a)(2), (a)(3), (a)(5), (e), (f), (h), (i), (k)). The ERISA section 206(d) antiassignment and alienation provisions—together with certain exceptions for qualified domestic relations orders—are also made applicable to the Federal thrift plan.

Third, participating financial institutions must at least annually provide participants with information on the status of their TRAS—the Board also has authority to receive such information, generally in summary form for all TRA's maintained by each participating financial institution.

Fourth, participating financial institutions would be required to provide participants with ERISA-like "summary plan descriptions" which describe the general features of the Federal thrift plan and the particular features of the TRA Programs offered by such an institution.

Fifth, participating financial institutions are prohibited from distributing amounts to participants unless first, the participant is eligible for disability or retirement benefits under another Federal Government pension plan or workers compensation program, second, the participant has been separated from Federal service for at least 31 days and the amount is transferred to a newly proposed pension portability vehicle to be established under title V of ERISA—termed a retirement-USA, or third, the participant has attained age 59½. Upon the death of a participant, the designated beneficiary or beneficiaries are eligible to receive distributions from the participants' TRA's. Regulations of the board would provide for procedures by which participants and beneficiaries would obtain written evidence of their eligibility for TRA distributions which in turn could be presented to and automatically accepted by the financial institution from which a distribution is requested.

Financial institutions offering qualified investment programs may—but are not required to—provide distributions to participants from their thrift accounts for purposes of, first, purchasing an automobile; second, making a down payment on a home or a home improvement; third, meeting the educational expenses of any member of the family; fourth, meeting general expenses in the case of hardship, or for any other purpose if the participant is otherwise eligible for a cash distribution—for example, in the event of retirement, disability, separation, or death. In order to encourage the maintenance of TRA's basically for retirement purposes, the amount of such a distribution is limited to the amount of the employee's own contributions which were elected to be made on an after-tax and not a salary reduction basis.

Under the Federal thrift plan a participant has a 100-percent vested interest that is, a "nonforfeitable right" as that term is defined under ERISA section 3(19)—in the amount in each of the TRA's maintained for such person regardless of whether the source of the amount is from employee contributions, employer contributions, investment earnings, or rollover transfers from other plans.

In accordance with regulations of the FTP board, the "pension asset managers" that may participate in the Federal thrift plan by offering "qualified investment programs" include—but are not limited to—banks, trust companies, federally insured savings and loan associations, registered investment companies—mutual funds—securities broker-dealers, and insurance companies.

The Qualified Investment Programs offered by such institutions may include any investment generally permissible under a private tax-qualified pension plan—or more familiar to some would be the investments offered by such institutions with respect to individual retirement accounts [IRA's]. By way of illustration such investments may include, but are not limited to stocks, corporate bonds, Treasury issues, certificates of deposit, guaranteed income contracts, mutual funds, mortgage funds, real estate funds, annuities, et cetera.

Section 8366 provides for a Federal fund.

A new Federal fund is established as part of the Federal thrift plan within which is invested employer contributions and any employee contributions optionally directed to the fund. The interest rate is to be set by the board.

The board is expected to obtain a rate of return on investments in line with private pension investment practices, as if the assets of the fund were actively managed. The rate of interest on the Treasury obligations in the Fund could not be less than the rate set under present law.

Section 8367 provides for enforcement.

In order to enforce the fiduciary and other standards applicable to investment programs, the board of the Federal thrift plan may exercise the investigative and civil enforcement authority similar to that provided the Secretary of Labor under ERISA.

The board may utilize the facilities and services of any Federal agency to carry out its functions.

Section 8368 provides for audits.

The ERISA-like audit and annual report requirements under chapter 95 of title 31, United States Code—as originally enacted under Public Law 95-595, the Federal Pension Plan Reporting and Disclosure Act—are applicable to the Federal thrift plan.

Section 8369 provides for FTP board.

The Federal Thrift Plan Board is composed of the Director of the Office of Personnel Management—or the Director's delegate—who serves as Chairman, the Secretary of the Treasury—or the Secretary's delegate—and the Director of the Office of Management and Budget—or a delegate.

Under section 8370, the board is authorized to prescribe any regulations necessary to carry out the provisions of the Federal thrift plan.

Section 8371 provides for tax qualifications.

Comparable to the situation for private plans, the Federal thrift plan is considered to be a tax qualified plan which meets the requirements of sections 401 (a) and (k) of the Internal Revenue Code and is considered to be a tax qualified trust which is exempt from tax under section 501(a) of such Code.

While those employee contributions made to the Federal thrift plan on an after-tax basis are not again taxed when distributed, the remainder of a participation's interest in a TRA is taxable at the time of distribution in the same manner as a distribution from a private tax qualified plan—that is, as ordinary income unless distributed as a lump-sum in which case a special 10-year income averaging method applies; special tax rules also apply in the case of annuities. Taxes on all investment income earned under a participant's TRA are, therefore, deferred until the time they are actually distributed.

Section 8372 provides for appropriations.

This section provides that appropriations be made to each employing agency to meet the employer matching contributions.

The provisions of title I establishing the Federal thrift plan are effective on the date of enactment, and employee and employer matching contributions to thrift retirement accounts [TRA's] would be allowed beginning January 1, 1986.

To bring the benefits and contributions of post-83 employees into conformance with the new program, the after-tax contributions—generally 1.3 percent of pay—deducted from such employees' pay pursuant to the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 are transferred to employee accounts under the Federal fund.

Amendments to civil service retirement and disability system are provided for under title II.

Section 201 provides for the definition of post-83 employee.

Employees—including elected and appointed officials—currently covered under the Civil Service Retirement and Disability System—including those hired before the commencement of mandatory Social Security coverage on January 1, 1984—continue to accrue pension benefits under their old CSRS formula—for example, for general employees 1.5 percent per year of service for the first 5 years, 1.75 percent for the next 5 years, and 2 percent thereafter; special categories have varying accrual rates.

Except for the special categories, employees subject to CSRS hired in 1984 or later and who are covered under Social Security by reason of the 1983 Social Security amendments are defined to be "post-83 employees." For years of service after 1983, such post-83 employees would accrue CSRS pension benefits—in addition to Social Security—at the rate of 1.20 percent for each such year of service.

Unless they make an irrevocable election to be treated under the new provisions for "post-83 employees," persons employed in the special category positions—whether first employed before or after 1983 would first, continue to contribute to CSRS under present rules—i.e. their contributions would not be eliminated as for post-83 employees—and second, accrue CSRS pension benefits under the currently applicable formula. The special categories include law enforcement officers, firefighters, air traffic controllers, congressional employees, judges, all elected officials and those categories of employees hired before 1984 who are to be covered under Social Security as of January 1, 1984—for example, certain Executive Schedule and noncareer appointees in the Senior Executive Service.

Any current employee who is not automatically a "post-83" employee may make an irrevocable election to be treated as a post-83 employee. The election of such post-83 status would not affect any employee's past contributions or benefit accruals, but would change the level of future employee contributions—none—and future CSRS benefit accruals—1.20 percent—with respect to any years of post-83 service performed after the election is made. Any employee making such an election would also be automatically covered under Social Security as of the time of the election—this is accomplished as a result of an amendment to the Social Security Act contained in Section 302). Positive results with respect to both employee benefits and the financing of the Social Security and Civil Service Systems occur as the number of current employees electing post-83 status increases. Accordingly, a number of incentives—described earlier—are contained in the FAIR legislation in order to encourage current employees to elect post-83 status.

Section 202 provides for the exclusion of new postal workers under the CSRS.

Officers and employees of the U.S. Postal Service hired after 1983 and who are covered under Social Security are excluded from the provisions of the Civil Service Retirement and Disability System—but are included in the Federal thrift plan, unless covered under a new defined contribution plan established by the Postal Service. The Postal Reorganization Act gives the Postal Service full power and authority to establish a Pension Program through collective-bargaining for such new employees—as well as other employees. In the future all pension and disability costs would be borne fully by the Postal Service, without indirect Government subsidy, as is consistent with the independent corporate status under which the Postal Service is expected to operate. On the request of the Postal Service the Office of Personnel Management could provide for the transfer to the new postal pension plan of some or all of the benefits and related plan assets for current postal employees.

Section 203 provides for CSRS exclusion of new employees of the District of Columbia.

General employees of the District of Columbia hired after 1983 and who are covered under Social Security are excluded from coverage under the Civil Service Retirement and Disability System. This is consistent with the charter given the District of Columbia under home rule and will allow the District to establish a plan for general employees just as it has for police, firefighters, teachers, and judges.

Section 211 provides for contributions.

The employee contribution rate under the CSRS for "post 83 employees" would be eliminated with respect to service after 1983. By definition "post-83 employees" are covered under Social Security and such persons would contribute at the applicable OASDI contribution rate on earnings up to the Social Security maximum taxable wage base.

Agency contributions would, as under current law, continue to match the level of current employee contributions, but only until regulations are in place which would require full actuarial "normal costs" to be contributed—see section 212.

Section 212 provides for full actuarial funding required.

Under FAIR the financing and solvency of the Civil Service retirement system and disability fund is enhanced first, by maintaining the one existing fund to provide benefits for both current and post-83 employees, second, by requiring that total contributions be sufficient to meet plan "normal costs" using "dynamic actuarial" assumptions, third, by requiring 40-year amortization of initial unfunded liabilities, and fourth, by providing the opportunity for enhanced investment earnings—see section 221. As a result of requiring DRISA-like actuarial funding, agency budgets will on an ongoing basis reflect realistic costs of retirement and disability benefits and any chance that the Civil Service fund would become technically insolvent would be eliminated.

During the Social Security debate some employee groups expressed their fears that a "new" system for employees covered under Social Security would lead to the "freezing" of the present CSRS and the operation of a wasting trust, thus putting present employee benefits in jeopardy. The continuance of the present CSR trust fund under FAIR and the full actuarial funding of benefits for both current and post-83 employees should eliminate such fears since they would have no basis in fact.

As soon as practicable after enactment, OPM is to issue regulations requiring each employing agency to contribute to the CSRS.

First, for each post-83 employee, a percentage of basic pay based on the dynamic normal cost of benefits for post-83 employees, and second, for each current employee, the percentage applicable to post-83 employees plus the rate of employer contributions to OASDI—5.7 percent in 1986. The above contribution rates will achieve parity with respect to employer contributions for both current and post-83 employees when both Social Security and CSRS contributions are considered.

In addition to the agency and employee contributions made equal to the plan's normal cost, a Federal Government contribution is to be made to the CSR Fund each fiscal year after regulations are in place in the amount required to amortize, in 40 annual installments as a level percentage of payroll, the unfunded liability of the CRS computed as of the first such year.

Federal Government contributions are also to be made with respect to any subsequent net increase in unfunded liability arising from plan amendments, experience gains or losses, or changes in actuarial assumptions. Such contributions are determined annually on a rolling basis and are computed so as to be equivalent to the amount of the first installment, as if the cumulative net increase in unfunded liability were to be amortized in level installments over 15 years.

All actuarial determinations of normal cost and unfunded liability are to be made using dynamic actuarial assumptions which take into account future expected salary levels—including general pay adjustments reflecting inflation—and post-retirement cost-of-living adjustments. This requirement differs from the present law funding basis under which "static" actuarial assumptions ignoring inflation and COLA's are used, thus resulting in the understatement of true actuarial cost levels. The dynamic basis is currently prescribed in connection with the actuarial valuation and disclosure of unfunded liabilities required under Public Law 95-595.

Section 221 provides for the investment board.

Consonant with private pension fund practice, the bill establishes a fund investment board for the CSRS consisting of the Director of the Office of Personnel Management—or the Director's delegate—the Secretary of the Treasury—or the Secretary's delegate—and the Director of the Office of Management and Budget—or the Director's delegate. It is the function of the board to determine, in active consultation with the advisory panel on fund investments, the interest rate at which investments of the Fund are to be made. The membership of the board is the same as that for the Federal thrift plan board.

The board is expected to obtain a rate of return on investments in line with private pension investment practices, as if the assets of the CSR fund were actively managed. The rate of interest on the Treasury obligations in the fund could not be less than the rate set under present law.

Section 222 provides for the investment advisory panel.

An Advisory Panel on Fund Investments is established to advise and assist the Fund Investment Board of the CSRS and the Federal Thrift Plan Board. The seven-member panel is drawn from among individuals generally recognized for their expertise in finance and investment generally and in private or governmental pension funds in particular.

Changes to CSRS retirement benefits are provided under part D.

Unless otherwise indicated the provisions under present law relating to CSRS retirement benefits remain unchanged—for example, the immediate eligibility and 5-year vesting rules continue to apply with respect to current employees as well as post-83 employees.

The FAIR bill makes a number of changes with respect to the benefits for employees terminated before retirement in order to overcome the criticism often directed at the present provisions of the Civil Service Retirement System which tend to create benefit disparities favoring high-paid long-service employees while providing few, if any, benefits for shorter-service employees, lower paid employees, and employees experiencing greater job mobility because of occupational or family necessity—for example, engineers and women. Generally, the following provisions instill a greater measure of pension equity and portability with respect to the benefits of such persons: 1) Sec. 232 eliminates the "back-loading" as under present law with respect to the future benefit accruals for post-83 employees, 2) Sec. 234 provides for the tax-free rollover into the Federal Thrift Plan of accumulated contributions that may be withdrawn by a terminated employee, 3) Sec. 235 offers short-service employees the option to rollover the present value of their deferred vested benefits into the Federal Thrift Plan, 4) terminated employees may elect, pursuant to Sec. 241, a survivor annuity at the time of termination, and 5) the availability of Social Security and the fully vested amounts in the Federal Thrift Plan provide additional elements of benefit equity and portability.

Section 231 provides for reduction for early retirement.

As stated in the May 14, 1983, Washington Post editorial, "Those Federal Pensions," Federal pensions are currently much better than even the most generous private worker plans together with Social Security; (for example), workers can retire at age 55 with 30 years of service on full unreduced pensions.

The FAIR bill takes a comprehensive approach to bringing about a more rational CSRS retirement structure with respect to deferred and early retirement benefits. The criticism of the Civil Service Retirement System will continue unless the present early retirement provisions are made more defensible and comparable to mainstream practices.

Therefore, section 231 provides that future retirement benefit accruals be reduced by 2 percent for each year actual age at retirement precedes age 65.

Post-83 employees would be able to retire under the same age-service provisions as under present law, but the amount of benefits based on service after 1983 would be subject to the 2 percent reduction factor. The 2 percent rule would not reduce the amount of any employee's benefit which is accrued prior to 1984.

It might be noted that the 2 percent early retirement adjustment factor is the same as the factor that currently applies to retirements under age 55. While the new 2 percent reduction under age 65 for early retirement is not equivalent to an "actuarial reduction," its application in combination with the post-83 benefit accrual formula (discussed in the next section) is designed to produce early retirement benefit levels comparable to the levels found in the major private sector pension plans. The effect of the early retirement reduction is also mitigated for post-83 employees choosing the so-called Social Security leveling option (see section 237) and also for those having Federal Thrift Plan accumulations which can be converted to early retirement annuities.

Section 232 provides for retirement accrual to be 1.20 percent for post-83 employees.

Under the bill, post-83 employees as well as current employees electing post-83 status accrue CSRS retirement benefits at the rate of 1.20 percent for each year of service after 1983. The accumulated accrual percentage is applied to high-3 basic pay as is the case under present law. The retirement benefit so computed is then subject to the 2 percent early retirement adjustment discussed under section 231. The accrual rates under present law continue to apply to current employees and employees in special occupational categories who do not elect post-83 status.

The following objectives were used to develop the accrual rate, the early retirement factor and other new retirement features of the CSRS as applicable to post-83 employees (who also accrue retirement benefits under Social Security):

First, combined retirement benefits from the revised CSR System and Social Security should, even coordinated, provide initial post-retirement income levels close to pre-retirement after tax income levels for "full-career"—30 to 40 years—moderate-income, employees who retire at age 65 or later. Such benefits should not be less than the benefits provided current employees retiring under similar circumstances; second, post-retirement adjustments should be provided to SCR pensions in order that initial levels of retirement income provided from Social Security and the CSR System not be significantly diminished because of future increases in the cost-of-living. The adjustments should be affordable, and they should be capped in order to maintain the fiscal integrity of the retirement system; third, revised CSRS retirement benefit structure should provide benefits comparable to those found under good retirement programs operated by major employers in the private and state and local government sector; fourth, for current employees electing post-83 benefit status, there should be no reductions in benefits already accrued; fifth, the revised CSRS benefit structure should be more equitable than the current one with respect to long-service versus short-service employees, especially as it applies to employees with split-service and occupations requiring job mobility; sixth, the provisions of the revised CSRS should meet ERISA standards and not be inconsistent with Internal Revenue Service regulations concerning the "integration" (coordination) of pension benefits with Social Security; seventh, the modified CSRS should be as simple to administer as possible and not be disruptive to the present system of delivering benefits; and eighth, the long-term costs to the Federal Government of the modified CSRS and the new Federal Thrift Plan plus the Government's contribution to Social Security should be more affordable than the current system.

Whie the current CSRS formula is "backloaded" (providing lower accruals for shorter-service employees), consistent with the objectives in five above the revised formula provides a constant 1.20 percent for each year of service. The simpler formula coupled with the continuation of other benefit computational rules as under present law, for example, high-3 pay, aggregation and service repurchase rules, et cetera—meets the objectives in seven for a simple nondisruptive revision.

The constant formula of 1.20 percent, taking into account Social Security benefits, was found to achieve the target replacement rates without having to resort to a more complex "integrated" formula. A 100-percent Social Security offset formula for determining retirement benefits (as advanced in order proposals) was considered but rejected since the approach would be contrary to current Internal

Revenue Service regulations on plan integration (see goal six above), would be administratively complex (see goal seven above), and would require a complicated and potentially inequitable attribution of Social Secretary benefits, especially with respect to shorter service employees (see goal five above). The 100-percent offset approach however, is utilized with respect to coordinating post-83 disability and survivor benefits with Social Security, since the offset approach with respect to such benefits does not violate the IRS integration rules, does not require inequitable attribution rules, and is the only approach guaranteeing the maintenance of current disability and survivor benefit levels.

An integrated formula is usually utilized in order to maintain a relatively constant "target" replacement rate at all income levels, since Social Security alone provides higher replacement rates for the lower paid. However, the annuity benefits available from savings accumulations under the Federal thrift plan bring the total benefits for employees having above average Federal earnings up to the target replacement rates for the lower paid (considering Social Security and CSRS benefits alone), thus allowing the simpler 1.20 percent formula to be used instead of a more complicated integrated one. The 1.20 percent formula accompanied by the Federal Thrift Plan is an approach similar to one advanced by the Universal Social Security Coverage Study Group (chaired by Joseph W. Bartlett) in its March 1980 report.

Section 233 provides for no post-83 minimum annunity.

The minimum retirement annuity under present law is necessitated since employees are not covered under Social Security. Since post-83 employees are covered under Social Security, a minimum is no longer necessary; thus the minimum is eliminated as being redundant.

Section 234 provides for the rollover of contributions of separated employees into TRA's.

Under present law an employee, upon early separation, may withdraw his or her contributions (without interest) resulting in the forfeiture of the employer purchased part of any deferred annuity. Section 234 provides that future withdrawals by either current or post-83 employees will automatically be rolled-over, tax free, into a TRA of the employee's own choosing.

Section 235 provides for portability for short-service employees.

Under this provision a terminated employee having 10 or fewer years of service may optionally choose to have the actuarial present value of the employee's deferred vested benefit directly transferred to the employee's account under the Federal Thrift Plan.

Section 236 provides for a 236 COLA limitation.

Under this provision the annuities payable with respect to post-83 benefits would have an annual cost of living COLA adjustment equal to 30 percent of the CPI. Based on a recent study commissioned by the Department of Labor, the 30 percent CPI COLA is comparable with the level of post-retirement adjustments extended to salaried employees under major private sector pension plans.

Section 237 provides for a Social Security leveling option.

A new retirement annuity option, termed a Social Security leveling option, is extended to post-83 employees retiring early in order that they may have a more level lifetime income rather than an income which jumps significantly when Social Security benefits become available.

To illustrate the application of this option—a post-83 employee retiring at age 55 with 30 years service would be entitled to a CSRS pension of 36 percent of high-pay subject to the early retirement factor of 80 percent (2 percent per year reduction under age 65) equal to $5,760 (in the case in which final high-3 pay is $20,000 expressed in current dollars); 10 years later at 65 the employee may elect to begin receiving Social Security benefits, thus nearly doubling the employees' retirement income level at such time; in the alternative the employee may elect the Social Security leveling option thus raising the person's initial level of retirement income at age 55 from $5,760 to say, about $9,500; at 65 when Social Security is elected and CSRS benefits are actuarially reduced under the leveling option, the person's total benefits would continue at the pre-65 level (subject to any applicable indexation).

An employee may elect that the increased CSRS benefit be paid under the leveling option up to any age selected between age 62 and 67 (when Social Security becomes available) at which time CSRS benefits are actuarially reduced to maintain a level income.

Section 241 makes separated employees eligible for survivor annuity.

Under the provisions of this section both current and post-83 employees who separate with vested benefits before reaching retirement age may elect to have a 50 percent survivor annuity paid to a spouse. The value of the survivor annuity and the reduced deferred annunity is to be equivalent to the value of the unreduced deferred annunity. This option is an alternative to the provision in present law under which a survivor is paid the lump-sum value of the employee's contributions in the event of the death of the separated employee before age 62.

Section 242 provides for an offset of Social Security Survivor Benefits.

Under FAIR the combined survivor benefits from Social Security and the CSRS are the same as under present law. In order to accomplish this, the CSRS benefits for survivors of post-83 employees are reduced by the amount of survivor benefits to which such persons are entitled under Social Security. Since Social Security childrens benefits generally exceed current law levels, the new plan is simplified by eliminating such benefits (with the exception of certain transitional benefits).

Section 251 provides for disability eligibility.

The conditions under which CSRS disability benefits are available for post-83 employees is changed to include that such benefits would not be available as long as the employee is able to render useful and efficient service in a vacant civilian position in a Federal agency within a reasonable commuting distance from the last place of employment. The employee's pay could not be reduced even though the pay in the new position is rated as low as 80 percent of the pay level of the former position. This provision is consistent with recomendations to the Congress made by the General Accounting Office.

Section 252 provides for post-83 disability annuities.

Generally, the amount of the disability annuity under CSRS to which a current employee may become entitled in the future is unchanged from that under current law.

The amount of the disability annuity to which a post-83 employee may become entitled under CSRS (including Social Security disability, if applicable) is in most cases improved over the disability levels under current law.This is to bring the level of CSRS disability more in line with private sector practices. The CSRS disability amount for payment years prior to the Social Security normal retirement age, presently age 65, is equal to the larger of (A) or (B) reduced by the amount of any disability benefits the person actually receives under Social Security, where (A) is the actual amount of the employee's accrued early retirement benefit taking into account the early retirement reduction factor, and where (B) is the lesser of first, the post-83 employee's high-3 pay, or 50 percent in the case in which the employee is receiving Social Security disability, or second, the alternative formula under present law but increased by 10 percent in the event the employee is receiving Social Security disability.

Upon attaining the normal retirement age under Social Security the disability benefits of a disabled employee are converted to normal retirement benefits and the individual would in addition be eligible to receive the full amount of Social Security benefits to which the person is entitled.

Section 253 provides that employee must apply for Social Security disability.

In order to maintain the integrity of the Civil Service Retirement and Disability System all employees applying for disability benefits under the CSRS must also apply for disability benefits under Social Security, unless exempted from such requirement under regulations prescribed by OPM.

Section 254 provides for Social Security disability offset.

Section 255 provides for a limitation of disability annuity based on excess earnings.

In order to encourage the rehabilitation of disabled employees and their return to full-time employment, the bill provides for the reduction in the amount of a disabled employee's annuity to keep the combined amount of the disability annuity and the amount of income earned by the disabled employee in other employment at a level not in excess of the final pay of the employee prior to disablement (adjusted for subsequent general pay increases).

This provision does not apply to a person receiving Social Security disability benefits or to a person enrolled in a rehabilitation program as described in section 256.

Section 256 provides for a disability rehabilitation pilot program.

Within 180 days after enactment the OPM is to establish a pilot program under which disabled employees (other than those receiving Social Security disability) would be provided vocational rehabilitation and the job placement counseling evaluation for purposes of determining the person's suitability for returning to the same occupation or another occupation for which the person is qualified by reason of training or experience.

The OPM may contract with the Secretary of Labor or with any insurance or other experienced vocational rehabilitation organization to provide such a pilot program. Within 5 years OPM would report to the Congress on the effectiveness of such a program together with any recommendations for legislation to establish a permanent program.

Section 257 provides for long-term disability coverage for new employees.

As under present law, current as well as post-83 employees would not be eligible for CSRS disability benefits until they meet the 5-year service requirement. Under this section employees may purchase long-term disability coverage for the first 5 years of employment, from insurance carriers at group insurance rates, under a federally sponsored program managed by OPM.

Section 301 provides for ERISA coverage for new Postal Service Pension Plans.

As stated under section 202, Postal Service employees newly covered under Social Security are excluded from coverage under the Civil Service Retirement and Disability System. Any new pension plan or plans established by the Postal Service for new or other employees would, under this section, be subject to the provisions of the Employee Retirement Income and Security Act of 1974 [ERISA] and the related provisions of the Internal Revenue Code.

Section 302 contains Social Security amendments.

This section provides for Social Security coverage for current civil service employees who elect coverage under both Social Security and the revised provisions of the Civil Service Retirement and Disability System applicable to new employees. The so-called "windfall" reduction under Social Security would be made inapplicable to employees electing such coverage in cases in which such employees have 10 or more years of post-83 service.

Section 401 provides for transfer of administration to OPM.

This section brings within the Federal Government [OPM] the administration of Federal retirement benefits now administered by the District of Columbia—for example, in relation to benefits for the Secret Service, the Park Police and others.

The Federal Annuity and Investment Reform Act, is designed to meet the many objectives enumerated earlier and in summary first, the revised system will provide initial retirement benefit levels equal to or close to preretirement living standards for full-career "post-83" employees at moderate income levels (considering Social Security and CSRS defined benefits only); a similar retirement income target for higher-paid employees is achieved when the annuity income from Federal Thrift Plan accumulations is considered; second, the initial retirement income levels for full-career post-83 employees retiring at 62 or later (when Social Security becomes available) are enhanced over current levels and are then indexed at 30 percent of the CPI; the availability of Federal Thrift Plan accumulations would allow for additional COLA supplementation; third, the revised 1.20 percent CSRS formula and the new Federal Thrift Plan are designed to be coordinated with Social Security in order to bring about greater benefit comparability with the pension arrangements offered by major private sector employers; additional benefit comparability is accomplished through the introduction of the 2 percent early retirement adjustment factor applicable to post-83 service and the 30 percent COLA limitation; fourth, the revised system is much more equitable in the manner in which it treats shorter service and mobile employees as a result of the portability offered by the fully and immediately vested benefits under both the Federal Thrift Plan and Social Security, the introduction of a constant accrual rate which is not "backloaded" as under present law, the tax-free rollover of employee contributions and certain other distributions into TRA's, and the availability of a survivor option for terminated employees; fifth, the revised system meets ERISA benefit and funding standards, and extends the tax benefits attendant with tax-qualified plan status to employee distributions from the CSRS and the Federal Thrift Plan. Any new plans established for Postal Service employees would be subject to the protections of ERISA; and finally the health of the OASDI trust funds are enhanced by several billion dollars per year as a result of the employee and Federal employer contributions to Social Security on behalf of current employees who elect post-83 status (a large percentage is expected to elect such status due to a number of benefit incentives offered).

Central Intelligence Agency

Washington, D.C. 20505

6 September 1985

The Honorable William V. Roth, Jr.
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

As your Committee begins consideration of S. 1527, the Civil Service Pension Reform Act, I want to thank you for your invitation to submit written comments on this measure. We have under consideration at OMB a legislative proposal which would permit the Central Intelligence Agency to administer a retirement program specially designed to meet the security and management needs of this Agency. Until OMB completes its deliberations, I believe it is premature to discuss this proposal. Therefore, with all due respect, I must decline your invitation to submit a statement for the record on S. 1527.

I do, however, take this opportunity to commend you and Senator Stevens for the difficult task you have undertaken to reform the Federal retirement system. As the head of an Executive Agency, I am well aware of the great significance a sound retirement system has to every Federal agency's management system. In the particular case of CIA, the specifics of a retirement system weigh heavily on our ability to recruit and retain top notch people, on our ability to maintain a high degree of security, and on our ability to manage our personnel with the flexibility and effectiveness necessary to carry out our complex and difficult missions.

I would hope that the subject of a retirement program for the Central Intelligence Agency can be a matter of discussion between us at an early opportunity. Until that time, I ask that you keep us in mind as you proceed through your hearings on S. 1527. With best wishes.

Sincerely,

William J. Casey
Director of Central Intelligence

THE CIVIL SERVICE PENSION REFORM ACT

PRESENTED FOR THE HEARING OF THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
SEPTEMBER 9, 10 AND 11, 1985
BY
DONALD S. GRUBBS, JR., F.S.A.
BUCK CONSULTANTS, INC.

SECTION A: INTRODUCTION

This presents comments on various aspects of Senate Bill S.1527, the Civil Service Pension Reform Act of 1985, as introduced July 30, 1985.

Section B following discusses the Basic Plan to provide pension income. Section C discusses the Thrift Savings Fund. Section D, prepared by Edward J. Winterbauer of Buck Consultants, Inc., discusses the Disability Benefits. Section E provides a few comments on communication of the program. Section F discusses benefits for federal employees apparently not covered by the bill, such as foreign service employees. An Appendix comments on certain sections of the bill and in some instances suggests alternative wording.

The views presented are solely my own, except that the views with respect to Disability Benefits in Section D are solely those of Edward J. Winterbauer.

The program is generally well designed. However modifications suggested herein would result in a program better suited to the needs of employees and the government, easier to administer and to communicate to employees, and less expensive.

SECTION B: BASIC PENSION PLAN

1. Eligibility for Retirement

a. Normal Retirement Age

The first age at which workers can retire with unreduced benefits is usually called the "normal retirement age". Congress previously determined that age 65 was a suitable normal retirement age for workers under Social Security, but in 1983, reflecting the growth in longevity and improved health of older people, Congress determined that the normal retirement age should be gradually increased to age 67. The Civil Service Pension System is designed to supplement Social Security for federal employees. There is no evidence that federal employees generally need to retire at an earlier age than the rest of the population. Therefore the normal retirement age for the Civil Service Pension System should be the same as under Social Security, age 65 gradually increasing to age 67, rather than age 62 as proposed. This change would result in substantial savings of tax dollars. The Corporate Pension Plan Study prepared by Bankers Trust Company showed that in 1980 97% of pattern plans and 95% of conventional plans of larger employers had a normal retirement age of 65, with reduced benefits generally payable for earlier retirement.

b. Law Enforcement Officers, Firefighters and Air Traffic Controllers

Some occupations, such as firefighters and law enforcement officers, require an amount of physical vigor that is less common at older ages. In jobs affecting the public safety, such as air traffic controllers, a decline in the degree of alertness by some older individuals may also justify a policy of earlier retirement for such employees. For such groups an earlier normal retirement age is suitable, if the government has no other job for which the individual is qualified in the vicinity of his prior work. It is understandable that a man in his fifties may be less able to climb the ladder with a heavy oxygen tank on his back. The sensible answer, however, is not to retire him but to transfer him to another government job he can do, if one is available.

The time when such a transition is needed is generally related to age, not to years of service. It is recommended that Congress specify an age, such as age 50, beyond which individuals in such categories could apply for transfer to alternative federal employment. If the Office of Personnel Management determines that no job exists which is within the employee's commuting area and which is not lower than 2 grades or pay levels below the employee's grade or pay level, the employee should be eligible for an unreduced normal retirement benefit. If the new job provided for a transferred employee pays less than the old job, the transferred employee should be paid a supplement equal to the difference, either payable as supplemental pay from the new agency or payable from the Basic Plan. This change would save money for the system, as well as retaining the services of capable employees for the government.

c. Involuntary Transfers and Reductions in Force

The bill provides for payment of unreduced pensions for employees who lose their jobs due to involuntary transfer or reduction in force, unless they refuse a suitable employment offer from the same agency. An employee who loses his job could begin receiving an unreduced pension in his forties, even though another federal agency across the street has a comparable job available for him. This would be a waste of tax dollars. Such an individual should be required to apply to the Office of Personnel Management for alternative federal employment. An interim pension could be paid until alternative federal employment is found or until the Office of Personnel Management determines that no suitable employment is available. In the latter event, the pension should become permanent. This change would save tax dollars and preserve the services of capable government employees.

c. Early Retirement

The proposed early retirement eligibility for a reduced pension is age 55 and 10 years of service. This is typical of private sector pension plans, and is recommended.

2. Amount of Retirement Benefits

a. Unreduced Normal Retirement Benefits

Selecting a level of pension benefits, like setting wage levels, is always a compromise between the desires for more income and less cost. The benefit formula for normal retirement benefits of 1% of pay times years of service appears generally satisfactory in light of the total package of benefits.

b. Reduced Pensions upon Early Retirement

The bill would reduce accrued pensions by 5% (2% for employees with 30 years of service) for each year that pensions start before the normal retirement age at which unreduced pensions are payable. The 5% reduction is slightly more liberal than most private sector plans, but is generally suitable.

Employees with 30 years of federal service have no greater need to retire early than other federal employees, who generally have less federal service only because part of their working career was outside the federal government. There is no rationale, from the viewpoint of employee needs, for using 2% instead of 5% for long service employees.

If the normal retirement age for unreduced pensions is set at age 65, gradually increasing to 67, as I recommend, the early retirement reduction should be made from such age rather than from age 62. Most private sector plans pay reduced pensions for those retiring before age 65.

3. Cost of Living Adjustments

If retirees are not to have their standard of living gradually eroded after retirement, pensions should be adjusted by the full CPI. However, the bill would make inflation adjustments of 2% less than the CPI each year. This means that the purchasing power of the pension would be reduced 26% in 15 years, and reduced 45% on 30 years. This is most undesirable. Providing pensions that are fully indexed to the CPI would be more costly than the 2% deficit proposed, but this extra cost is approximately equal to the cost saving resulting from the change in retirement ages I have recommended.

SECTION C: THRIFT SAVINGS FUND

1. Fixed Income Investments

a. Governmental Securities Investment Fund

Fund A, the Government Securities Investment Fund under the bill would be invested in 2-year notes. Some have questioned whether the duration should be shorter or longer. In answering that question, one must first explore why the program includes this fund in addition to Fund B, the Fixed Income Investment Fund, since both would be invested in fixed income investments.

The rate of return on fixed dollar investments varies with duration. But for any particular duration, the rate of return on private sector securities is generally higher than for U.S. Treasury securities. Unless there are reasons to do so, a government securities fund should not be offered at all.

One possible reason for the two alternatives is the belief of some that government securities offer greater security of principal. While this is true for a particular bond, it is not true for a widely diversified portfolio of such bonds. Even during the depression Salomon Brothers long-term high-grade corporate bond total return index outperformed an index of long-term government bonds. Both government and corporate bonds assure protection of principal in the long term, since the occasional loss of principal on a defaulted corporate bond is more than offset by greater interest on other corporate bonds, compared to government bonds. Guaranteed investment contracts (GICs) and certificate of deposits

(CDs) offer comparable security. Thus security of principal is not a reason for offering a Government Securities Investment Fund.

A second possible reason for a government securities fund is because some employees might feel that it is more secure, even if that is incorrect. Experience shows that this is not generally true. Few people select federal government bond funds over corporate bond funds, and very few people select federal money market funds over money market funds invested in private sector investments.

A third possible reason for a government securities fund is to help support the market for federal securities. It seems improper to ask federal employees to finance the government through a lower rate of return.

A fourth possible reason for a government securities fund is that initially a government securities fund is faster and easier to get started. It can be started before procedures are established for selecting and managing a portfolio of private sector securities. This is a valid reason for initially investing a fixed dollar fund in government securities until the Board is prepared to handle private sector investments. It is not a reason for having two separate fixed income funds.

A fifth possible reason for having a government securities fund is that it might be a fund of shorter duration securities. Fund B, the Fixed Income Investment Fund, may be invested in long-term and intermediate-term investments. It may be desirable to have a second fund invested in short-term investments. A discussion of whether it is advisable to have a short term investment fund will be addressed shortly; but assuming that a short-term fund is desired, it should not be limited to government securities for other than an interim period described above. For short-term securities, as for long-term securities, higher returns are generally obtained in the private sector.

For the above reasons, I recommend against a government securities fund. The issue of a short-term fund is discussed in subsection (c) below.

b. Fixed Income Investment Fund

The bill would allow the Fixed Income Investment Fund to be invested in (1) annuity contracts issued by life insurance companies, (2) certificates of deposit issued by banks and savings and loans associations and (3) bonds, notes, bills and other fixed income securities (governmental or non-governmental) selected by qualified professional asset managers. The investment would be carried out by the Executive Director under policies established by the Board. This appears satisfactory.

Some prefer to spell out more detail in the statute. The interests of participants are apt to be best served by establishing a Board of highly qualified individuals and giving them wide latitude.

Such a Board would be far more competent than Congress and its staff to establish investment policies and procedures. In addition, it would be in a position to appropriately modify these from time to time when conditions change, as they surely will.

Apparently some propose to limit the investment to guaranteed investment contracts (GICs) issued by life insurance contracts. At one point in time these may be the best available fixed dollar investments. At another time the Board may determine that a diversified portfolio of bonds will offer participants a better rate of return; in this case a restriction to GICs would be adverse to participants. The Board should be free to seek the highest rate of return, within acceptable limits of risk and other investment guidelines. The Board could establish objective criteria for determing suitable levels of risk and duration, and seek the highest return among investments satisfying the criteria.

To whatever extent GICs are used as an investment medium, the Board should be free to seek competitive bids, subject to limits on diversification of risk (not more than a fixed percentage of fund assets from any one issuer, be that an insurance company, bank, or other corporation). The approach of Federal Employees Group Life Insurance (FEGLI), which allocates coverage among all major insurers, would defeat the goal of obtaining competitive rates.

The Board can gain whatever qualified personnel is needed in the same manner as corporations and state governments have done for similar funds, by hiring staff, retaining consultants, or both.

All fixed dollar investments fluctuate in market value. The fluctuation is most apparent for publicly traded bonds (both governmental and non-governmental), for which the fluctuation can be read in the daily paper. Fluctuations are just as real for private placement bonds, which must be sold by negotiation. GICs and CDs are subject to penalties on premature withdrawal, which also make their market value different from their cost or their amortized value.

A fundamental question is whether unrealized changes in market value under the Fixed Income Securities Fund should affect account balances. I believe they should not. (See Appendix note on section 8401(10).) Because employee withdrawals from the Fixed Income Securities Fund prior to termination of employment are restricted, the fund will always have a positive cash flow. It will never be necessary to sell securities prior to maturity to meet cash flow needs. Under these circumstances all investments can be made with the expectation that they will be held to maturity. All assets can be valued at amortized cost. When occasionally the Board determines that an investment should be sold prior to maturity, the realized gain or loss would not be significant. Even this fluctuation can be cushioned against if a small portion of the investment income received is set aside as a reserve for asset fluctuation.

The bill would allow interest to be credited annually or more frequently, as the Board determines. It specifies that the rate credited be the actual rate earned less administrative expense. Under this provision the rate to be credited could not be determined until after the end of the fiscal period and after the accounting for it is completed. This could delay the crediting of interest and the payment of benefits. Instead the Board should be able to make an estimate of the rate at the beginning of the fiscal period, so that when an employee terminates he can be immediately credited with interest for the period or part period, under rules determined by the Board. Suggested statuary language is included the Appendix.

c. A Short-Term Fixed Income Fund

The Fixed Income Investment Fund would generally be invested in securities with terms of longer than two years. Should there also be a short-term fixed income investment fund?

If participant accounts under the longer term Fixed Income Investment Fund were subject to market value fluctuations, there would be a reason to offer an alternative short-term fund, which would be free of such fluctuations. But if, as I have recommended, participant accounts under the longer term fund are not affected by market value fluctuations, this need does not exist.

Yields on short-term fixed dollar investments have generally fluctuated far more than yields under longer term instruments. Occasionally the yields on short-term instruments have been higher, but in most periods they have been lower. Over the 58-year period ending in 1983, for example, the average annual rate of return on 20-year government bonds was 0.4% higher than the average annual rate of return on short-term Treasury bills. Few employees would have the astuteness or luck to jump back and forth between the funds at the right moment. For most employees, investing in a short-term fund would be expected to produce a smaller accumulation at retirement than investing in a longer term fixed income fund. For this reason it is recommended that no short-term fund be included.

If, however, a short term fund is to be included, it should not be limited to government securities, since that would tend to lower the return. Short-term funds are usually invested in securities with durations ranging from 90 days to 12 months, and this would appear satisfactory for such a fund.

2. Common Stock Index Investment Fund

The bill's provisions regarding the common stock fund appear satisfactory, with two exceptions.

First, the Board should be given broad authority to exclude investment in particular stocks or classes of stocks. This may be desirable for investment reasons (e.g. a corporation in reorganization) or for social policy reasons (e.g. investment in South Africa). (See Appendix A comments on section 8427(b)(2)(B)).

Second, if the government is put in the position of voting its corporate shares, a Pandora's box is opened. Shares owned by the Fund should not be voted. (See Appendix comments on section 8495.)

3. Minimum Percentage for Government Securities Investment Fund

The bill would require that certain early year contributions be invested in the Government Securities Investment Fund. The stated reason for requiring this is to reduce the administrative and financial impact of the new plan. It is not clear that such a limitation is needed, although limiting the plan to a single fixed-income fund initially could facilitate and expedite the start-up process. But if there are to be such schedules, the administrative cost can be reduced, and the plan will be easier for employees to understand, if (1) the two schedules of minimum percentages are identical and (2) all percentages are either 100% or 0%. Apparently the primary objective is to build up the assets of the Government Securities Investment Fund in the early years. Approximately the same result can be achieved by requiring 100% for both schedules for the years 1987 through 1991 and 0% thereafter. This would be far easier to understand. Having only a single fund until some date would (1) eliminate the need for elections in the earlier years, (2) eliminate the need to establish the other two funds earlier, (3) allow more time to do better planning for the above two functions and (4) reduce administrative expense. A year earlier than 1992 could be used for removing the restrictions but whatever date is used, the percentages should be 100% for both funds for prior years and 0% thereafter.

4. Distribution of Investments between Funds

If the three funds designated by the bill are not modified, our experience indicates that approximately 30% of employee contributions will be invested in the Government Securities Investment Fund, 50% will be invested in the Fixed Income Investment Fund, and 20% will be invested in the Common Stock Index Investment Fund. Of course this will be altered by requirements that part or all of contributions be initially invested in the Government Securities Investment Fund.

5. Eligibility for Participation

The bill makes all employees eligible from their date of hire. The principal disadvantage of this is the administrative work for very short-service employees. The advantages are that (1) employees who stay for an extended period can benefit from the plan for their entire career and (2) the sign-up can be a routine part of processing new employees. Most employees who don't expect to stay at least one year will not elect to join. The advantages appear to outweigh the disadvantages, so no change is recommended. The bill appropriately excludes employees hired in temporary employment positions.

6. Disabled Participants

Conceptually it appears desirable to allow participants to contribute to the Fund out of their disability income. As a practical matter most probably could not afford to do so, since their disability income would only be 60% of their regular pay. Thus only the few with the least financial need could afford to contribute. Allowing for such contributions from individuals who are no longer employed would add administrative complexity. For these reasons, this is not recommended.

The bill would allow distribution of benefits when a participant separates from government employment. Ordinarily a participant would separate from government employment upon becoming disabled, and thus would be eligible to receive his account balance from the Fund. Individuals on sick leave ordinarily have no special need for a distribution of their accounts. If there are any significant number of disabled individuals who do not separate from government employment after sick leave has expired, provision should be made to allow them to receive their accounts.

7. Vesting

The bill provides a scale of graded vesting in the account balance as follows:

Years of Participation	Vesting Percentage
Less than 1	0%
1	20
2	40
3	60
4	80
5 or more	100

A scale which is 0% up to a certain point and 100% thereafter is easier to administer and easier for employees to understand then a graded scale such as the above. I recommend against a graded scale.

If the plan provides 100% vesting at all times, it is even easier to administer and communicate. The number of accounts that must be kept is cut in half, since there is no longer a need to keep a separate employee and employer account for each employee.

Deferred vesting creates forfeitures, reducing the employer's costs. Otherwise earlier vesting is desirable because it encourages participation and because there is no reason why short-service employees should forfeit part of their accounts.

8. Hardship Loans

Hardship loans definitely add significant administrative expense, both in administering the loan initially and in administering the payback. Like all loans, they create tax inequity by allowing non-taxable distributions. They also create tax hardship; the individual who borrows his entire account balance one year and terminates employment five years later is suddenly hit with a tax liability when he has no money with which to pay the tax. I recommend against hardship loans.

Hardship withdrawals are not as bad as hardship loans, since hardship withdrawals have only the initial administrative problem. Nevertheless, I recommend against hardship withdrawals for that reason.

If, however, hardship loans or hardship withdrawals are to be included, hardship should be very strictly defined for administrative simplicity, avoidance of disputes and prevention of abuse.

9. Administrative Structure

The bill would establish a three-part administrative structure for the Thrift Savings Fund:

(1) a Civil Service Thrift Investment Board, composed of high government officials, to set policy for both investment functions and administrative functions,

(2) a Civil Service Thrift Advisory Committee, composed of three investment experts and three plan administration experts to advise the Board for both investment functions and administrative functions, and

(3) and an Executive Director and staff to carry out both investment functions and administrative functions.

The Office of Personnel Management (OPM) administers all other parts of the program, including the Basic Plan, Survivor Benefits and Disability Benefits.

The operation of the Thrift Savings Plan has two clearly separate parts, investment functions and administrative functions. The administrative functions are very similar to the administrative functions that OPM provides for all other benefit programs specified in the bill, as well as health insurance and others. The administrative functions of the Thrift Savings Fund can be most efficiently handled by assigning them to OPM.

The investment function is entirely separate, however, and requires different kinds of knowledge and abilities. One advantage of separating the two functions is that the body responsible for investments can be composed entirely of people who are knowledgeable concerning investments. Under the bill the only members of the Board who are really well qualified to set investment policy may be the Director and the Chairman of the Federal Reserve Board, the latter of whom is probably far too busy to give the Fund much attention; while only three of the six Advisory Committee members would be knowledgeable concerning investments.

If, as I recommend, the Board's functions are limited to investment matters, the Board should be composed entirely of individuals selected for their expertise in investments. If the Board is composed of such persons, there would be no need for an Advisory Committee.

10. Administrative and Investment Expense

The bill would have administrative and investment expenses deducted from investment income. This is an approach commonly used by defined contribution plans covering state and local government employees, as well as by many corporations. Other plans divide expenses between investment expenses, which are subtracted from investment income, and administrative expenses, which are either paid by the employer or assessed to individual accounts on a per capita basis, e.g. $12.00 per year per participant. In some plans both investment and administrative expense are paid by the employer. Each approach works satisfactorily.

11. Other Administrative Considerations

The majority of the communication of the Thrift Savings Fund to employees can be most efficiently handled as part of the total employee benefits package. This is discussed in Section E of this presentation. But one key element of communication is the preparation of an individual statement for each participant showing the status of his account and the changes during the accounting period.

Such statements can be produced annually, semi-annually, quarterly or monthly. They are a bi-product of the recordkeeping process.

Plans differ greatly in the extent to which they perform tasks internally and the extent to which they are contracted out. In the long run the program can probably be administered less expensively internally, using outside consultants solely in an advisory capacity as needed. Initially, however, greater use of contractors may help the program get off to a faster and better start. This is true in the areas of communication, account recordkeeping and administrative procedures.

In the area of participant recordkeeping the Board could use the assistance of outside contractors either by having a contractor perform the recordkeeping and production of employee benefit statements or by purchasing or leasing software that has already been tested by wide use.

Annual investment expense should be under 0.50% of average assets, although first year expenses could be somewhat higher. In the case of a GIC or CD the direct investment expense paid by the Board would be lower than otherwise, since the internal investment expense of the insurance company or bank is passed through in the form of a lower interest rate and is unseen.

Turn around time on payment of benefits depends upon whether payment is based upon a system that awaits the next valuation, and upon the frequency of valuations (monthly, quarterly, etc.). Some plans, for example, require that an application for benefits be filed a month before a valuation date and pay benefits four to six weeks after the valuation date. Other plans, using mutual funds with daily valuation of assets, manage to pay benefits within a week of the application for them.

Most administrative functions can be handled by the Board or OPM without any specific statutory direction, and indeed probably better without Congressional direction, because of the greater expertise of OPM or the Board in such matters.

SECTION D: DISABILITY BENEFITS

There are several areas in which the long term disability (LTD) plan differs from plans typically offered by private employers. Some of the differences will make the proposed plan difficult to administer. The following are provisions that should be of particular concern.

1. Commencement of Benefits

The proposed LTD plan covers employees after 18 months of service, and benefits commence after the disabled employee's sick leave is exhausted. Consequently, the plan has a variable waiting period that could be as short as zero days for employees who have used up all accumulated sick days. The plan, as described, could be liable for short-term claims from such employees as long as they are "unable ... to render useful and efficient service." Unless the plan is redesigned to eliminate coverage for short-term illnesses, the plan administrator should expect to be swamped with disability claims.

2. Determination of Disability

The use of two alternative definitions of disability is common in LTD plan design. However, the plan's less strict "occupational" definition which "requires only that the individual be unable to do any job for which he or she is qualified, in the same federal agency, commuting area and grade level" is much more liberal than the typical "any occupation" definition written into the majority of private plans.

The "any occupation" definition requires that the disabled employee be unable to perform any work for which he or she is reasonably suited by education, training, and experience. Continued disability is determined solely on the basis of medical evidence and not on the availability of reemployment with the original employer.

As written, the plan would require continued interface between the plan administrator and government personnel to determine whether a job is available in the same federal agency, etc. for those who are able to return to work.

In the event that a federal agency plans to relocate a facility or to reduce employment in an area, the plan would encourage employees to file disability claims.

The provision that allows continuation of disability payments to those who earn income of up to 60% of pay level of the job held at onset of disability is probably unique. Generally, employees who choose to engage in gainful employment are removed from the disability rolls unless the plan makes provision for a limited duration of rehabilitative employment.

The provisions will encourage the filing of disability claims since the plan allows an employee to take home up to 120% of pay through disability payments and other employment.

Again, continued interface between the plan administrator and government personnel would be required to track the annual increases in the allowance for earned income.

Since disabled employees with earned income exceeding the 60% level can come back onto the disability roster if income falls below the 60% level, it may be impossible to drop employees from the disabled population roster prior to death or attainment of the limiting age.

3. Disability Benefit Amounts

The use of "high-5 salary" in determining benefit levels is unusual and may lead to higher benefits for short-service employees than for longer service employees with identical current salaries. This would result in an inflationary economy from the use of a shorter salary averaging period for short-service employees.

In the presence of little or no wage inflation, the 60% of high-5 average pay would seem to be adequate for those who meet the "Social Security" definition of disability. The 40% benefit may be inadequate for those who are truly totally disabled but who are not approved for Social Security disability benefits since they are judged to be able to perform some gainful work.

Almost all LTD plans offset primary Social Security payments. Many also offset full family benefits. A study of after-tax income replacement ratios would help in judging whether the plan should offset family rather than primary Social Security.

Typically, private LTD plans do not make provision for cost-of-living adjustments. However, an annual adjustment should not add significantly to the cost of plan administration.

4. Retirement Benefits After Disability

As written, disability benefits would terminate at age 62 (or age 55 for those who meet only the occupational definition of disability). Consideration should be given to modify plan wording to clearly eliminate the possibility of simultaneously receiving both disability and retirement benefits for those who may retire at earlier ages (e.g., law enforcement officers, fire fighters, air traffic controllers, and national guard technicians).

Typically, private plans include provisions to "carve out" retirement plan payments.

5. Claim Approval

Typically, private employers supply information on eligibility and salary levels to plan administrators, and the administrator is fully responsible for the determination of disability, calculating gross and net benefits, making payments, and producing both routine and special experience reports.

The plan described in S.1527 will require the federal government to supply considerably more information both for initial and ongoing disability determination. As a result of both plan complexity and the large number of agencies and locations involved, considerable centralization of the governments responsibilities would be required.

6. Net Benefit Determination

Most private plans include provision to carve out Social Security and Workers' Compensation benefits as well as certain other items. Plan administrators generally require that disabled employees file information regarding receipt of Social Security and Workers' Compensation benefits. In the event that a disabled employee fails to supply the requested information, a presumption is typically made that the employee is receiving such benefits (particularly Social Security) and an estimated amount is carved out of the LTD payment.

SECTION E - COMMUNICATION OF THE PROGRAM

It is recommended that the communication program for the new benefits program include the following elements:

(1) A plan for communication

(2) Training of key personnel department employees in the agencies

(3) A very brief summary of the entire program to present the highlights of the program in simple language, to be provided to all affected post-1983 employees initially, and to all new employees in the future. A modified version should be prepared for firefighters and other groups with special provisions.

(4) A summary plan description for each part of the employee benefits package, providing more detail concerning each. This could be in the form of a booklet for each benefit program (including the health benefits program that covers the employee) and a container for the collection of booklets (or possibly a notebook with sections).

(5) A film to explain the program to all post-1983 employees, designed for projection in auditoriums or on VCRs for small scattered groups. This might be a lively animated film, like some corporations have used to spark and sustain interest. The showing of the film could be followed by question and answer sessions.

(6) Well designed forms and form letters

(7) Separate communications for pre-1984 employees explaining their right to transfer to the new program

(8) Annual comprehensive individual benefit statements, summarizing benefits under all parts of the program, including the amounts of

the participant's accrued and projected Basic Plan pension, his projected Social Security benefit, his Thrift Savings Fund benefit, his disability benefits, his death benefits from various sources, and his medical benefits.

Communication of the program can be designed by OPM without any specific statutory direction.

SECTION F: FEDERAL EMPLOYEES COVERED UNDER OTHER SYSTEMS

It has been long recognized that the maze of retirement systems covering federal employees is inappropriate. In a 1978 study the General Accounting Office identified 38 separate systems. In its report (Need For Overall Policy And Coordinated Management Of Federal Retirement Systems Volume I, FPCD-78-49) it stated, "We have found that the lack of an overall, coherent Federal retirement policy, along with independent system development and piecemeal changes, has resulted in many inequities. Coordinated management of Federal retirement systems is needed."

In a few instances, such as the Military Retirement System, a separate program is appropriate. But in most instances there is no logical reason for providing different federal employees with differing benefits. The way to equitably phase out of this is to cover all new employees of all agencies in the new Civil Service Pension System and Social Security, except in a few categories with clearly differing needs. Benefits should be identical for all employees, except where the physical demands of the job, public safety or an up-or-out compulsory retirement policy dictates earlier retirement. The President's Private Sector Survey or Cost Control found no justification for differing benefits for foreign service employees, other than those forced to retire under the up-or-out program.

Appendix

COMMENTS ON THE TEXT OF S.1527 AS INTRODUCED JULY 30, 1985

Title 5 USC Section	Comment
8401(10)	"Yield" should be changed to "investment income", since the term "yield" ordinarily refers only to interest, not to dividends. "Received" should be deleted, since earnings should be on an accrual basis. In the case of the Common Stock Index Investment Fund (but not the other two funds) "earnings" should include unrealized appreciation and depreciation of market values. Thus subsection (10) should be reworded as follows: "(10) the term 'earnings', when used with respect to the Thrift Savings Fund, means the amount of investment income, the amount of realized gains on the sale of assets, and, solely with respect to the Common Stock Index Investment Fund, the amount of unrealized appreciation in market value of assets;"
8401(11)	The period during which the 9 months occurs should be defined. I suggest adding "during the period the participant was an employee" after the word "months." Otherwise a former spouse could claim benefits even if the marriage ended many years before the participant became an employee.

8401(18) Subsection (18) should be reworded as follows:

"(10) the term 'loss', when used with respect to the Thrift Savings Fund, means the amount of realized losses on the sale of assets, and, solely with respect to the Common Stock Index Investment Fund, the amount of unrealized depreciation in market value of assets;"

8415(a) To allow the use of approximate factors for simplicity, add the following: "Such regulations may provide for the use of factors which approximate precisely determined actuarially equivalent factors."

8416(a)(2)(C) Delete "and who has an insurable interest in the annuitant." Determination of who has an insurable interest is not necessary and adds complexity to the administration and communication of the plan. Most plans allow the employee to designate any one he wants for such a purpose. Since the benefits are an actuarially equivalent amount, there is no significant cost to such elections.

8416(b)(2)(A) Add "or if the Office determines that the existence or whereabouts of a spouse are unknown" at the end of subparagraph (A).

8421(a)(1)	"Thrift Savings Fund" (called Thrift Savings Plan" solely in the subchapter title) is more name than the plan needs. Shorten it to "Savings Fund" here and elsewhere.
8427(a)	Communication is slightly simplified if the names of the three funds are shortened. I suggest "Common Stock Fund", "Fixed Income Fund" and "Government Securities Fund", to be used here and elsewhere. The use of shorter titles is particularly helpful in designing forms.
8427(b)(1)(B)	Change "insurance contracts" to "group annuity contracts" to avoid misunderstanding and to avoid any claim that life insurance contracts or individual annuity contracts should be used.
8427(b)(2)(B)	It is recommended that the Board be given broad authority to exclude investment in particular stocks or classes of stocks. The Board might decide to do so for investment reasons (e.g. a corporation in reorganization) or for social policy reasons (e.g. investment in South Africa). Add the following: "However the Board is authorized to refrain from investing in any particular stock or class of stocks included in the index or to disinvest in any such stock or class of stocks for such reasons as it deems appropriate."

8427(e) See Section C page 14 of this statement. The two schedules of minimum percentages should be identical and all percentages should be either 100% or 0%. Approximately the same result can be achieved by requiring 100% for both schedules for the years 1987 through 1991 and 0% thereafter.

8427(f) The average rate seems to be the average rate for all outstanding 2-year maturity notes, regardless of the period to maturity. At any particular time the yield on 2-year notes with only 30 days to maturity might be quite different than for 2-year notes just issued. The latter would appear to be the most appropriate basis. I suggest substituting "the 2-year notes most recently issued" for "all 2-year notes." A further problem could result if the notes issued to the Thrift Savings Fund become the majority of all outstanding 2-year notes, tending to be an anchor against changing the interest rate to reflect changes in market interest rates. Before "then forming" add, "other than notes issued in accordance with this subsection,".

8428(a)(3) In order to facilitate administration and expedite payment of benefits, add the following at the end of paragraph (3): "The Board may adjust the preceding to reflect any increase or decrease in a contingency reserve as it deems advisable. In lieu of the preceding, the Board may determine an interest rate to be credited to each such account for any fiscal period by determining such rate as an estimate of the amount that would otherwise be allocated under this paragraph."

8433(b)(2)(B)	After "spouse" add, "or if the Office is unable to determine whether a spouse exists or to determine the whereabouts of a spouse,".
8434(a)	Section 8434 fails to consider the possibility that the participant elects the joint and survivor at the time of retirement, divorces, then remarries and then also elects the joint and survivor for the second spouse. Would both spouses get the joint and survivor protection? Could three spouses each receive 50% of the pension? It is recommended that no second joint and survivor election be allowed if one is in effect. After "elect" insert, "if no former spouse survives who may become eligible for benefits under this System with respect to the participant,".
8462(d)	To clarify that a $1.00 increase is not required if the increase in the price index does not exceed 2%, after "section" add "for any year in which the amount described in paragraph (2) of subsection (b) is positive".
8471(a)	The bill apparently fails to state that CSRS members who elect to be covered under CSPS will be covered under Social Security.
8495	Add subsection (g) as follows: "(g) No person shall exercise any voting right with respect to any securities held by the Thrift Savings Fund."

Atlanta
Birmingham
Boston
Charlotte
Chicago
Cleveland
Dallas
Denver
Detroit
Hartford
Honolulu
Houston
Los Angeles
Miami
Minneapolis
New Orleans
New York
Philadelphia
Phoenix
Pittsburgh
Portland
Richmond
St. Louis
San Diego
San Francisco
Seattle
Wilmington
Calgary
Edmonton
Montreal
Quebec
Toronto
Vancouver
Winnipeg

JOHNSON & HIGGINS
Established 1845
INSURANCE BROKERS-AVERAGE ADJUSTERS
ACTUARIES-EMPLOYEE BENEFIT PLAN CONSULTANTS

Buenos Aires
Adelaide
Brisbane
Hobart
Melbourne
Perth
Sydney
Belem-Para
Belo Horizonte
Campinas
Curitiba
Porto Alegre
Rio de Janeiro
Salvador
Sao Paulo
Santiago
Bogota
Cali
London
Paris
Torino
Milan
Rome
Padua
Tokyo
Auckland
Christchurch
Wellington
Lima
Hong Kong
Singapore
Taipei
Caracas
Maracaibo
Puerto La Cruz

CABLE ADDRESS "KERODEN NEW YORK"
TELEX NO. 420027

95 WALL ST., NEW YORK, N.Y. 10005
TEL 701-7500 AREA CODE 212

September 18, 1985

Senator William V. Roth, Jr., Chairman
United States Senate
Committee on Governmental Affairs
Washington, D.C. 20510

Re: Civil Service Pension System (CSPS)

Dear Senator Roth:

Thank you for your letter inviting my comments on a proposed Civil Service Pension System. This system would cover all Federal employees hired on and after January 1, 1984. In addition, employees under the CSRS plan hired prior to 1984 could opt for the new plan with respect to service to be rendered in the future.

In my opinion, the proposed CSPS is a significant improvement over the existing CSRS. However, the CSPS would still be too liberal relative to practices in the private sector and relative to the cost burden to be thrust on taxpayers. Since we are talking about employees who will generally have many years in the plan before retirement, and since history suggests that pressures will be generated for improvements in benefits as time goes on, would it not be best to start out with a more modest plan? A building block approach could then be used later on as plan improvements are required and monies become available for the funding of increased benefits.

Here are specific comments on the CSPS proposal:

1. The basic pension benefit is geared to retirement at age 62 with at least five years of service. If people stay in the work force longer because of changing demographics and practices, it seems more logical to

plan for age 65 or even age 67 as the norm going into the far ranging future. In this context, I would take issue with the statement that "age 62 is the most common age for the receipt of unreduced retirement benefits under private pension plans." The average age for unreduced benefits is clearly higher than age 62 today and it will probably be even higher going into the next century.

2. The COLA adjustment with its 2% deduction under CSPS is certainly better than current practice under Social Security. However, it is far more generous than what private plans provide. The fact that it would be "guaranteed" also seems unnecessary compared to the ad hoc practice of private employers.

3. The actuarial reduction of 5% for retirement below the normal retirement age is reasonable. Why ruin a perfectly good formula by adding the provision of a reduction of only 2% if the employee has thirty years or more of service? This could be an unnecessarily expensive provision.

4. The Thrift-Savings Plan is generous relative to the private sector. The one-for-one match is to the left of current practice. However, there is some offset because of the relatively slim pension formula as it applies to higher paid employees.

   The Thrift-Savings Plan should follow the same tax rules which would apply to private sector plans. Therefore, if Treasury II or whatever else passes happens to knock out or curtail the employee tax advantages of 401(k) Plans, the identical treatment should be extended to the Thrift-Savings Plans.

5. While I understand the underlying theory of requiring contributions to go to Fund A for early years of the plan, I do question the appropriateness of this mandatory requirement in terms of the employee's own contribution. The plan would be much more attractive to the employee if Funds B and C are available at the outset with respect to the person's own contribution. The employer contribution could still be forced into Fund A, although in an ideal world even this should not be made mandatory.

6. Over a period of time, Fund A will likely produce a poor result for the participants vis-a-vis Fund B. This suggests that the Fund B option should be made available just as soon as possible.

   Fund C is an interesting option which makes sense. Since the aggregate monies available will eventually grow to giant proportions, Fund C is a very practical solution.

7. While many details would have to be resolved the proposed Thrift Plan administration appears satisfactory in its broad outline.

8. As to the long term disability plan, let's hope that the experience doesn't parallel what has historically happened with the Social Security disability benefit. Specifically, a "strict" interpretation at the outset may well lead to pressures for administrative liberalization, which in turn will explode into an unacceptable cost burden. There should be a strong resolve to administer the benefit in a strict fashion indeed and for the long term.

   I am opposed to a special "occupational" disability benefit. These kinds of benefits are very awkward to administer and typically involve highly subjective determinations. The result could be a blank check approach which is inconsistent with the objectives of a reasonable benefit program. Why look for trouble, particularly when the focus should be on a starter plan and not on a lush benefit for people to abuse?

9. On the surface, the provisions covering transfers of pre-1984 employees to the CSPS seem reasonable. However, an adequate number of test examples should be developed to make sure that the bulk of the transfers will not be those who would win under the CSPS (rather than staying with the CSRS). In analyzing the examples, the full impact of Social Security should be taken into account.

The employer cost of the proposed plan is probably understated. The estimates were based on a 3% employer contribution for the Thrift-Savings Plan. With a dollar-for-dollar match, I would think the participation will be heavier than 3%.

Again, on the estimated cost the basic pension is approximated at 11.7% of pay to represent the normal cost. This is a very high figure by private sector standards. It suggests that the benefits are too rich by those particular standards. A typical normal cost in the private sector is on the order of 3% to 6% of covered pay.

The replacement rate analysis done by the Congressional Research Service creates an awkward comparison. To be realistic, the replacement rates should be computed on a spendable income basis, i.e., both post-retirement and pre-retirement income should be adjusted by the effect of the employee's income taxes, the employee's Social Security tax and the contribution to be made by the employee to the Thrift-Savings Plan. This spendable income analysis will show sharply higher replacement rates and offers a more realistic view of the real world.

The Research Service analysis converted the Thrift Plan fund at retirement to an annuity with a full cost-of-living adjustment. This understates the replacement rate compared to the basic CSPS COLA adjustment and compared to general practice with respect to private plans.

The proposed plan is not integrated directly with Social Security. The leverage provided by the Thrift-Savings Plan is intended ~~to generate an~~ implicit form of integration. Whether or not this works out in practice is open to question. One advantage of the proposal -- it's easy for employee understanding. One disadvantage -- lack of direct Social Security integration may have a spillover effect on private plans where conditions (and benefit formulas) are quite different.

I realize that there are conflicting forces at work in the development of CSPS. However, it is hoped that the comments herein will prove helpful in your deliberations.

Sincerely,

Kenneth Keene

Kenneth K. Keene, F.S.A.
Senior Vice President

KKK:me

✓cc: Mr. Richard Schreitmueller

Kwasha Lipton

Written Testimony of Kwasha Lipton
for the Senate Committee on Governmental Affairs
on Selected Aspects of S. 1527
September 6, 1985

A. Background Information

Kwasha Lipton has prepared this written testimony to address selected issues raised by the staff of the Committee on Governmental Affairs with respect to the bill in question. Our comments follow the numbering given in the paper headed *S. 1527 -- Design Alternatives and Questions*.

B. Thrift plan fixed-income investments

The Fund A Problem

Our understanding of how Fund A would appear to a participant is as follows.

- Each year, a minimum percentage of the participant's salary reduction amount would have to go into Fund A. The 1987 percentage would be 100%, grading down to 0% by 1992.
- Each year, a minimum percentage of the matching amount would have to go into Fund A. The 1987-92 percentage would be 100%, grading down to 0% by 1997.
- The participant will be precluded from electing to sell out of Fund A and reinvest in another fund if there would be less than the minimum percentage of Fund A in the participant's account after such sale.
- Unrealized gains or losses in the Fund A account will not be allocated to employees.
- The rate of return associated with any particular issue bought by Fund A will be based on the average of all 2-year notes then forming a part of the public debt of the United States.

Based on present market conditions, we anticipate that Fund A may well yield 1% or 2% less than Fund B. There are several reasons for this.

- The Federal Government borrows money at a lower rate than other issuers of non-tax-exempt bonds.
- Short term investments yield less than intermediate term investments.
- An insurance company GIC is backed by the insurer in total, not any identifiable assets in particular. This creates an ability to pool credit risk, an opportunity to price the product, and even tax considerations to the insurer all of which lead to high credits.

- Hence, the insurer GICs (which may be backed by 5-10 year investments) will outperform Fund A under most conditions.

- Furthermore, the GIC marketplace will currently permit arrangements where the participant cashes out at par so that there will be no market risk to offset the higher yield.

- Finally, "major" insurance companies are perceived to be totally secure, so participants will not value the additional security of government bonds over major insurers' GICs.

The relationship between GIC returns and government bonds is not set in stone; there have been periods when insurers have had difficulty matching short term returns. To the extent that the 1987 investment market shows the same material spread between insurer GICs and two year government bonds that is now present, we anticipate some problems with the proposed treatment of Fund A. In particular, the notion of requiring employees' salary reduction money to go into Fund A when Fund B is a better deal would cause problems in a private sector employer.

Employees may well tolerate employer-directed investment of "company money" — this issue actually arises in the profit sharing situation with respect to company stock. However, there is a lot less tolerance for being kept out of a more attractive investment alternative with "employee money". People will wonder why their salary reduction money has to support the federal debt.

To the extent that Fund A can be improved, this problem is mitigated. We have some observations about duration in the following section of the testimony; in today's market we do not see a way to get Fund A returns up to the Fund B level by alternative durations.

If there is a concern about forcing participants into Fund A against their will, consideration might be given to lifting the Fund A restrictions with respect to the salary reduction amounts while leaving the Fund A restrictions in place (or even tightening them) for the matching amounts.

Under this scenario, employees would have free choice with "their" salary reduction money, but the government's matching money would have to go into Treasury obligations. No roll-out of matching money would be permitted. This approach would generate long-term, predictable positive cash flow to Fund A and support a longer duration of investment — and hence a better return.

Answers to specific questions in Section B

B1. Under the proposed rules for Fund A, there is no need to keep investments short because of unpredictable cash flows. If participants cannot sell out of Fund A at will, and if Fund A maturities are reinvested in Fund A, a materially longer maturity than two years is supportable. This argues for longer maturities, and correspondingly higher credits.

Unfortunately, the artificial nature of Fund A greatly complicates the question of duration.

- o Unusual cash flow: If participants avoid Fund A as much as possible, there will be little or no new cash flow from participants after 1991 or from the Government after 1995. The maturing of present obligations, less cash needed to pay former participants, will be the sole source of cash flow at that point.

- o Artificial asset value: Cashing out former participants at par rather than at market will not introduce too great a distortion with two year bonds; it can become a problem if the spread between par and market is large. The longer the duration, the larger the potential spread.

- o Artificial credited rate: To purchase obligations whose rate of return is based on an average rather than on current conditions at a point in time represents another departure from market place reality.

Given the proposed rules, there are several important disadvantages to longer bonds.

- o There may be "holes" in the cash flow if longer bonds are bought in quantity. As an example, if a material amount of 15 year bonds are bought and participants minimize their Fund A elections there will be very little to invest in 1996-2000; no new money and no maturities. Hence, the average yield will not include a proportionate representation of whatever returns are at that time. With two year bonds, there will always be rollover money to invest.

- o Should the cash flow go negative and sales be required, the realized capital losses can be material if longer bonds are in the portfolio. Again, with two year bonds there is less risk.

- o A two year average rate will respond faster to market changes.

- o It will be harder to liberalize the rules for Fund A if it is backed by long bonds. Suppose, as we anticipate, that Fund A is clearly and consistently less satisfactory to participants than Fund B. At some point, someone may decide to change the law and let participants reallocate their existing salary reduction accounts. If this sort of change is made when interest rates are high, there will be a much larger shortfall between par and market if the portfolio is long.

B2. The FEGLI analogy is not on target, in our view. FEGLI is, of course, a major commitment of the primary insurer; however, it is small potatoes to the reinsurers. A FEGLI reinsurer is assigned some small percentage of a huge term life program; a series of large accounting entries are made; and a small annual check from the reinsurer to the insurer, or vice versa, is written. No problem.

By contrast, the investment and reinvestment of billions of dollars of thrift plan proceeds will involve real cash and require real work, not just accounting entries. If the cash is allocated out from the selected primary insurer to the reinsurers on a formula basis like FEGLI, the only force to maximize reinsurers' credited interest rates is corporate citizenship. If the cash is allocated out from the insurer to the reinsurers by competitive bidding, the Government has in effect delegated the competitive bidding process to an outside agency. And while such a delegation may be indicated (discussion follows), there is no obvious need to use a reinsurance mechanism for it.

Competing syndicates is a more promising idea; the competition between Blue Cross/Blue Shield and Aetna for Federal employees' health benefits probably served a valuable purpose, especially in the early days. It is possible that syndicates will form on their own just to handle the immense cash flow of the new plan; it is even possible that the "capacity" of the insurance companies to issue GICs will be strained by this flow of dollars. However, we have concerns about a syndicate being given an "exclusive" as is the case for FEGLI.

The federal government is, of course, expert in running competitive biddings as part of the national debt management process. It might be well to tap this experience to design the competitive bidding process. For our part, we have a specific suggestion for competitive bidding Fund B.

o Every quarter, an auction will be held for investments of the following quarter. Insurance companies will bid for participation under a standard contract form which stipulates every relevant detail and leaves nothing to chance.

  An insurer can match cash flows with investments fairly readily on a quarterly basis, so that there is less risk to the insurer. As a result, the insurer will not need to hold back on credited return.

  It is not necessary to credit separate quarterly rates to participants just because the investments are made on a quarterly basis, as discussed below.

o Bids will be awarded in decreasing order of yield.

o To preclude concentration of risk problems, a methodology will be developed to limit the maximum concentration of assets in an insurer or syndicate.

o As far as the (limited) state of the art permits, bidders with less strong financial conditions will be kept to a lower limit; some bidders will be kept out.

This bidding program would be easier if credit considerations could be ignored. Unfortunately, the Baldwin United experience has demonstrated that the State guarantee funds are not reliable for group annuities and that the State regulatory monitoring process can trail events rather than forecast them.

Furthermore, troubled institutions are just the ones whose cash flow needs lead to aggressive pricing so these companies show up at or near the top of the list in offered yield. It is essential that the superintendent of bidding be permitted to remove companies from the list even if their offers are generous and even if their insurance departments have not classified them as in any way troubled.

B3. The suggested standard contract could be developed by some sort of commission with Government and insurance company representation; because the competitive bidding of GICs is a well established process in the private sector, a number of consultants and brokers exist who could advise the Government on this matter on a fee for service basis.

We suggest quarterly bidding; the January bid will be for the quarter beginning July 1, etc.

Our recommendations on the guaranteed rate process are covered in the following section.

C. Thrift plan administration

We have two suggestions for thrift plan administration that fall outside the specific questions.

I. Adopt a rolling estimate approach on the fixed income fund instead of separate accounting: Private sector 401(k) plans must meet the "separate accounting" requirements of the Code and Regulations. This involves separately allocating gains, losses, forfeitures and other credits or charges on a participant by participant basis (Proposed Regulation 1.404(e)(2)). A consequence of the separate accounting process is that any problem with one participant's account causes problems with all other participant's accounts.

By and large, the private sector has solved the problems associated with this "reconcile each valuation to the dollar" requirement. However, it is not easy for a large organization with many payrolls to do. More importantly, we see no way we see for a multitude of investments made during a year to exactly support any guarantee.

Here is the approach we suggest for the GIC fund. At the beginning of each year, or a shorter period if such is warranted, an interest rate will be declared for the fixed dollar component of the thrift savings. This interest rate will be credited to participants' accounts, whether or not the underlying investments exactly support it.* An end-of-year final accounting will reconcile (1) the actual investment results earned from the underlying investments and (2) the dollars credited to individual accounts. The resulting "difference account", which may be positive or negative, will be combined with prior years' results and rolled into the next declared rate.

In this environment, the operations of the difference account will buffer one participant's records from problems with another participant's accounts. Furthermore, it will allow for an annual rate guarantee to the participant declared in advance in combination with quarterly bidding which we consider to be the best of both worlds.

II. Adopt a Unit Value System for the Stock Index Fund: The stock index fund does not involve any guarantee approach, of course. In this case we suggest conventional mutual fund accounting based on unit values. The accounts are valued periodically; units are bought or sold; and the ratio of assets to units at any point in time gives a unit value. The participants' accounts are maintained in terms of units, and the dollar values are computed by multiplying units (from the record-keeping system) by unit value.

This approach is familiar to many people, and will work well for the Stock Index Fund. Note that it separates the record-keeping process into two distinct activities -- participant level record-keeping and overall fund accounting.

A "difference account" may still be required because of the occasional timing problems that will result in ordinary administration. However, there will be no component of this account attributable to the spread between the investment credit guaranteed to participants and the actual investment result.

III. The Government Securities Fund could be handled either way: We do not have strong feelings about whether the guaranteed rate (with its associated "difference account") or the unit value approach (reconciled each valuation period) is preferable. Either should work.

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* Should interest rates change dramatically in the future, the plan administrator might want to open up a new "generation" -- deposits on and after January 1, 1989 for example -- with an interest credit appropriate to conditions at that time. We can provide details on this possible future refinement.

Answers to specific questions in Section C

C1. As noted, we anticipate that the government securities fund will be very unpopular. Of the monies that participants have control over, 5% Fund A; 80% Fund B; and 15% Fund C might be plausible. Should interest rates continue to drop, the popularity of Fund B might drop with it; however, it seems likely that the gainer on this scenario would be Fund C, not Fund A.

C2. In most private sector situations we would suggest a 3 - 6 month wait. Actual government turnover experience should be considered in this decision.

C3. Withdrawals: Disabled employees will want to have access to thrift plan balances for any number of understandable reasons. We suggest that they be permitted to withdraw some or all of their balances if they wish. Additions: The private sector employers almost never continue disabled employees in the thrift plan, so there is no way for basic, voluntary or matching contributions to be made. Long term savings programs with a retirement orientation are not relevant to this group, and there is frequently no payroll record from which to make salary reductions.

C4. There is no substantial ease-of-administration argument for full and immediate vesting.

C5. Hardship/Loan: In the private sector, there is a distinction between loans and hardships. Loans must be repaid, with interest at a fair rate; other than the tax deduction for loan interest, there is no tax effect from a loan. Furthermore, the loan can be used for any purpose.

By contrast, hardships are withdrawals. They are taxable events; there is no provision for repaying them; and employees have to be able to demonstrate the hardship.

We suggest that neither loans nor hardships be included in the thrift plan at this time. The administration of either provision may pose difficulties, with the (more popular) loans even tougher to do than the hardship withdrawals. Furthermore, framing the criteria for hardship withdrawals has proven a difficult task for the Treasury and the area still lacks clarity.

After a few years, when the administration of the Thrift Plan has settled into a routine, this decision can be reconsidered.

Communications: Communications will be key to the success of the new program. The "typical" private sector thrift plan operates without any direct tie-in to such other benefits as the pension plan and the LTD plan. Here is the communications cycle for a new thrift plan.

- Getting started: Employees will need to acquire a good deal of initial information about the plan. Common private sector practice allows for the following elements:

  an initial "teaser" setting the stage for the plan;

  a highlights brochure, preceding the group meeting;

  group meeting, at which audio visuals and question-and-answer periods are available;

  a follow-up brochure and election forms so that participants can join; and,

  an employee booklet giving all the rules and procedures of the new plan.

- Staying informed: A number of ongoing communications keep employees up to date on their thrift plan.

  The essential employee communications piece is the periodic statement of account balances.

  Participants will need to know what the historical results of the funds have been so that they can make an informed investment choice.

  Fund B (and perhaps Fund A) will also have expected future returns that need to be communicated.

  There may be changes in rules, forms and procedures to respond to new governmental requirements or to reflect improvements. As a consequence, the employee booklet will have to be updated at least every few years.

We would be happy to supply samples of each of these if there is an interest. In some form or other, each of these elements should be considered for the new thrift plan.

There are a number of firms and individuals who have installed and administered thrift plans over the years. Furthermore, there are private sector firms with multiple locations, multiple payrolls and multiple lines of business who have successfully communicated and administered these programs. It can be done. However, it requires a full-scale commitment to communications.

There is one giant complicating factor in S. 1527 for which there are few private sector analogues. Pre-1984 employees have apparently been given a choice between the CSRS (without a thrift plan and with one LTD plan) and the CSPS (with a thrift plan and with a different LTD plan). How does an employee decide? There are pro's and con's to both, and the choice is essentially irreversible.

Further thought is required as to how a communications campaign can be developed for the pre-1984 employees; this will be a large challenge. Query: can the thrift plan be turned into a separate decision unlinked to pension and LTD? Perhaps the associated cost increase can be moderated by dropping the proportion of pay that is matched.

C6. See discussion above.

C7. In house/contracted services: Large (and small!) employers absolutely must manage the payroll process, to include accomplishing the salary reduction; calculating the company match; remitting funds to the investors and data to the record-keepers; reconciling remittances and data to the satisfaction of the record-keepers and the auditors; processing change and termination requests; answering questions and correcting errors. These are all difficult jobs that cannot usually be delegated to contractors.

The contracted services will typically include a record-keeping organization that manages the participant-level records; one or more investment advisors for any equity options; insurance companies for the GICs; and a custodian or trustee for the non-insured assets. Many large companies may use a separate contractor for each of these functions; other large and most small companies will ask a contractor to play more than one role (investment advisor and custodian, for example). Furthermore, outside contractors are often used for the very specialized communications function -- especially when a new plan is launched.

What should be done: We anticipate that the federal government will have its hands full for several years accomplishing the unavoidable minimum payroll-driven activities, and -- if this is the case -- it would make sense to use outside agencies for record-keeping. In theory, there should be no difficulty finding a number of organizations able to play the various roles (see below).

C8. We are not in a position to estimate the expenses of the program; obviously, these expenses would be a small percentage of the annual deposits under the plan.

C9. Small employers who look to one organization (an insurance company, for example) to provide complete services for a thrift plan may pay the insurers' costs in part through investment income. In our experience, large employers will almost always pay expenses by separate payment.

C10. Lead time: Launching this program by January 1, 1987 will require tremendous quantities of hard work and luck and would have to be characterized as distinctly against the odds. The development of new payroll fields and procedures for flowing data to the record-keeper and cash to the investors would be the key; the communications process would also be a major effort. Getting the investment funds in place is not likely to take more time than either of these efforts.

Contracting: In the private sector, record-keeping services are sold on a fixed price basis and the concept of allowable cost contracting is virtually unheard-of. Thrift plan administration costs a small percent of thrift plan deposits; thrift plan deposits are only one part of the fringe benefit cost; it just isn't worth anybody's time to get involved with cost plus arrangements.

The business is highly competitive, and there are a number of potential suppliers of record-keeping services to the federal government. Furthermore, it might be practical to have several different record-keepers for different segments of the government. However, we are not sure that an industry that has grown up in a fixed price tradition will be attuned to government cost-plus contracting.

D. Long-term disability

The Occupational Definition Problem

The proposed long term disability plan includes one distinctly "severe" definition of disability and one distinctly "generous" definition. We must caution that the very generous definition of occupational disability may generate long term cost problems.

Long term disability is a remarkably inexpensive benefit for a largely white collar work force -- 1/2% of payroll often suffices -- but only if the benefits are restricted to cases of real disability. The slightest tinge of severance pay can cause costs to multiply dramatically. We worry that a few managers will use the occupational disability as an outplacement device, and we worry that a few employees may also abuse the plan on their own.

It only takes a small percentage of problem cases to raise the LTD claim cost over what might otherwise be anticipated. The financial dynamics of a well-designed and well-administered LTD plan produce a very small number of claimants many of whom get a relatively large payout. Only a percent or two of severance pay problem cases will geometrically increase costs down the road.

Furthermore, while we applaud the concept of using contracted services, the contractor will have to operate within the statutory framework. It will be very hard to knock out a dubious occupational disability case from a distance -- especially if the employee and his management both want the case paid.

An alternative

In the private sector, the concept of a "generous" and a "severe" definition of disability is well established along different lines that may mitigate these problems. Simply put, the employee need only meet the generous definition for the first year or two of disability; at that point, the severe definition comes into play.

This could be adapted to the new plan with beneficial results. From the employee's point of view, there will be 6 to 18 months between when the Social Security test is failed and the occupational disability benefit expires; this gives the employee time to rejoin the workforce in some other capacity before the occupational disability benefit stops.

Answers to specific questions in Section D

D1. High-5 average pay is not commonly used in an LTD formula; current rate of pay is typical. The 60% number is not out of line (but see comments below); the treatment of occupational disability is unheard of, as noted above.

D2. 60% less primary social security is somewhat stringent for employees who cannot qualify for family benefits and distinctly generous for employees (especially lower-paid employees) who can. As an alternative, one can consider such formulas as 2/3 of salary less full social security subject to a minimum of $100 a month. There are numerous variations on this theme.

D3. COLAs on LTD are virtually unheard-of in the private sector.

D4. The absolute essential is that employees must be precluded from collecting from both LTD and sick days at the same time.

o One approach defers the start of LTD until sick days are used up.

o Another approach gives the employee a choice between using sick days or LTD benefits.

o A third approach "caps" the accumulation of sick days at approximately 120 (which fills the six month waiting period); however, we doubt if this would be acceptable to federal government workers.

D5. Large employers typically want to have their insurer or administrator handle all aspects of claim payment. On this basis, the insurer can act as a buffer when unpopular decisions must be made.

From the point of view of the LTD plan, employers with this philosophy pay the premiums, provide pay and service data on claimants, answer their insurer's questions, and let it go at that.

Centralization: If a single insurance company or administrator is selected, uniformity of practice -- and, perhaps, economies of scale -- can be anticipated. On the other hand, as observed above in other contexts there are distinct advantages to multiple and competing suppliers.

D6. LTD plan administrators can require claimants to supply information on the status of their social security claim and withhold payment of LTD benefits until the information is supplied. Once the potential for other benefits like Workers Compensation is verified, a similar approach can be taken there.

S. 1527 — Design Alternatives and Questions

A. Background information

Currently the federal government has about 2.5 million civilian employees, with an annual payroll in the neighborhood of $65 billion. The new program covers all those hired on or after January 1, 1984, estimated at about 500,000 by the plan's effective date of January 1, 1987, and any existing employees who elect to transfer in during the open season scheduled for 1987.

Annual employer-employee thrift plan contributions would be roughly $1,500 per eligible employee in 1985 dollars, and so would be about $750 million in 1987, eventually leveling off at some $3.75 billion each year when all employees are covered. On this basis the thrift plan funds held for active employees would eventually reach some $50 billion.

Plan provisions are intended generally to be based on experience in the private sector, modified as needed to accommodate existing practices in the Civil Service Retirement System or other federal requirements.

B. Thrift plan fixed-income investments

1. Regarding Fund A (government obligations), what should be the duration of the government securities? Section 8427(f) of the bill proposes 2-year notes. This has been criticized by some as too short, in view of the longer durations found in investments of other federal plans. But it has been criticized by others as too long, in view of thrift-plan equity and risk considerations such as the annual elections available to employees.

2. Assuming that Fund B is invested in Guaranteed Investment Contracts (GICs), should this operate like the Federal Employee Group Life Insurance (FEGLI) program, with a master contract, a single insurer and numerous reinsurers under a cost-plus arrangement, or should it instead use competitive bid procedures to place funds with different insurers from time to time? Could insurers form bidding syndicates that compete with each other?

3. How would the government acquire the expertise needed to operate a GIC fund with competitive bids? How often would a new contract be placed with an insurer? How would a single annual guaranteed interest rate be determined that blends the various portfolio rates?

C. Thrift plan administration

1. What percentages of employee contributions can be expected to go to the three funds (government securities fund, GICs or other fixed-income fund and common stock index fund)?

2. Should the thrift plan cover all employees from date of hire, as currently drafted? If not, what eligibility rule would be appropriate?

3. Should disabled employees be allowed to put money in, take money out, or both if they wish?

4. Is full immediate vesting substantially easier to administer than graded vesting, for an employer without centralized personnel records?

S. 1527 — Design Alternatives and Questions

C. Thrift plan administration (continued)

5. Would a hardship-loan program add significant expense to the thrift plan? Are any other features of the plan unduly complex for the federal government to administer? What minimum employee communication efforts would be needed?

6. How are employee account balances computed and paid out? How much delay is normal? Would it help to declare a flat interest rate each year for Fund A (government securities) in the same manner as is customary for a GIC fund?

7. What tasks do large employers customarily perform in-house, what do they contract out, and what should the federal government do? How much centralization is appropriate?

8. What range of administrative expense can be expected to establish and maintain the plan?

9. How are the expenses of administering a thrift plan normally paid—out of investment income, by separate employer payment, etc.?

10. How much lead time is needed from date of enactment until the thrift plan contributions can begin? Until all three investment funds can be operational? (Outside contracts would have to comply with normal government contracting requirements. Government staff would be under an executive director to be appointed after enactment.)

D. Long-term disability

1. Is the proposed gross benefit adequate, at 60 percent of high-5 average pay for those who meet the "social security" definition of disability and 40 percent for those who meet the "occupational" definition? (The definitions of disability are in Section 8441(4) of the bill.)

2. Is the offset, 100 percent of primary social security, appropriate?

3. What cost-of-living adjustment is normally used in private plans for the gross benefit, offset and net benefit after offset? (The proposed plan uses a COLA for the gross benefit that is 2 percentage points less than the CPI, with the social security offset going up at the full CPI rate.)

4. How should the LTD plan and sick leave be coordinated? (Employees earn 13 days of sick leave each year, less whatever sick leave they use.)

5. What claim-approval tasks do large employers customarily perform in-house, what do they contract out, and what should the federal government do? How much centralization is appropriate?

6. How do LTD plan administrators get the information needed on benefits payable from social security, workers compensation, etc.?

Unionmutual

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September 6, 1985

Dick Schreitmueller
United States Senate
Committee on Governmental Affairs
Washington, DC 20510

Re: S.1527

Dear Mr. Schreitmueller:

I am honored at being asked to provide input to S.1527. My reply has five sections:

I. Answers to your six specific questions

II. A general overview of LTD Plans and specific comments on the LTD Plan proposed in S.1527

III. An Analysis of the linkage between the Pension and LTD Plans of S.1527

IV. Comments on Potential LTD claim control problem with the S.1527 LTD Plan.

V. Summary

I. Answers to your questions

1. Is the proposed gross benefit adequate, at 60 percent of high-5 average pay for those who meet the "social security" definition of disability and 40 percent for those who meet the "occupational" definition? (The definitions of disability are in Section 8441(4) of the bill.)

   Most private LTD Plans provide 60% of current salary less integration offsets, therefore, anyone qualifying for Social Security receives a benefit equal to or better than the industry standard. The 60% benefit may be better than most private plans, since LTD plans integrate with more than just Primary Social Security. Having a different benefit percent depending on dual definitions of disability is rare. Most LTD Plans have an "own occ" definition of disability for the first 24-60 months of disability and an "any occ" definition thereafter. However, most plans integrate with any income earned from another occupation during the "own occ" payment period. A few plans use the individual disability definition of "own occ" and do not integrate.

2. Is the offset, 100 percent of primary social security, appropriate?

Private insurance has about a 50/50 split between 100% primary and family and 100% primary integration. Integration with less than 100% is rare.

3. What cost-of-living adjustment is normally used in private plans for the gross benefit, offset and net benefit after offset? (The proposed plan uses a COLA for the gross benefit that is 2 percentage points less than the CPI, with the social security offset going up at the full CPI rate.)

Private insurance COLA adjustments are usually ½ CPI to a maximum of 3% or 6%. COLA is fairly rare in the marketplace with only about 3 million out of 25,000,000 LTD insureds having it. Private insurance applies the COLA adjustment to the net benefit payable and not the gross. However, most private plans freeze the Social Security amount the plan is integrated with once it has been granted.

4. How should the LTD plan and sick leave be coordinated? (Employees earn 13 days of sick leave each year, less whatever sick leave they use.)

Ninety five percent of all recipients receive some sort of income continuance during the LTD elimination period, whether it be salary income, WI, or a state Disability Plan. S.1527's LTD plan smoothly transitions from sick leave to LTD without gaps in coverage or double income, thereby providing good coverage.

5. What claim-approval tasks do large employers customarily perform in-house, what do they contract out, and what should the federal government do? How much centralization is appropriate?

Employers do not have the authority to make claim decisions. They are required to furnish their insurance carrier with the necessary information for claim determination. Insured Employers furnish disabled employees with the necessary forms to file a claim and assist those individuals in applying for other income benefits such as Workers Comp, S.S.D.I., State disability benefits, pension benefits, etc.

The Federal Government should utilize the services of a T.P.A. to provide it with claim determination advice. The role of the Federal Government would be the same as indicated in Paragraph 1 for insured Employers.

Centralized processing of claims is the most desirable from the standpoint of uniformity of claims determination. However, local claims determination is better from the standpoint of visits and rehabilitation program.

6. How do LTD plan administrators get the information needed on benefits payable from social security, workers compensation, etc.?

Insurance Carriers obtain the data relative to amounts of other income benefits by including questions on the claim forms completed by employers and disabled employees. If necessary, such information may also be obtained by carriers from other providers of these benefits by direct inquiry to these other sources with the proper consent of the disabled employee.

II. LTD Plan Overview

The following is a typical LTD Plan.

[50%, 60%, 66 2/3%] of salary payable after [90,180] days of disablement, payable to age [65,70], with salary offset by [Family, Primary] Social Security, Workers Comp, State Disability Benefits, Rehabilitation Benefits (income received from employers while undergoing rehabilitation), Pension Disability Benefits, and Pension Retirement Benefits. The definition of disability is "the inability to perform the material duties of your occupation for [2,5] years, and the inability to perform the material duties of any occupation thereafter."

Waiting Period

Most Plans have a 30 to 90 day waiting period before individuals are eligible for group coverages. S.1527 plan's 18 month wait is rare, but would be an effective deterrent to anti-selection. High blue collar groups tend to have longer waiting periods, sometimes varying by grade level.

Elimination Period

Elimination periods vary in private plans from 30 to 360 days, with most being 90 or 180 days. Since most plans have some sort of income continuance during the elimination period, the S.1527 plan's elimination period and the income continuance are equal to private plans. However, if the sick leave elimination period results in an average elimination period less than 90 days, the total cost of the sick leave plus LTD plan will rise as discussed under cost control below.

Benefit Percent

The 60% benefit percent for the first year and thereafter for recipients of Social Security is consistent with private plans. The 40% is not consistent, but may be appropriate considering that the S.1527 "own occ" definition is easier to meet than that of private plans.

Based on Union Mutual's Social Security experience, the 40% may cause some unnecessary harassment to those who may be legitimate "any occ" claimants. One third of our claimants who eventually receive Social Security have not had their SS benefits approved or are in the appeals process 15 months after disability. For these claimants you will pay them 60%, then 40% while they are going through the SS approval or appeal process, and finally 60% again once they have been approved.

Questions: If they receive a retro-active Social Security award, will the LTD benefits be recalculated for that period, and if monies are due, the extra monies paid? If the claimant is actively pursuing SS, will he continue to receive the 60% benefit?

Benefit Duration

Most private plans have benefit durations of to age 65 or 70 which blend in with Social Security and Pension Retirement programs. The S.1527 LTD plan seems to blend in properly with the proposed pension plan and Social Security with early retirement, except where noted in the following section. However, note that private LTD transitions into full Social Security Retirement while S.1527 transitions into early retirement Social Security. If the claimant does not receive Social Security benefits, then the LTD benefit terminates at age 55, a practice not done in private plans. The expiration date is the same, usually age 65, for all claimants regardless of which definition of disability they are being paid on.

Integration

Private plans integrate with any combination of the following:

Primary or Family Social Security
Workers Comp
Short Term Disability Plans
Pension Disability Benefits
Pension Retirement Benefits
State Disability Plans
Rehabilitation Earnings
(income received from employer while undergoing rehabilitation)
No Fault Benefits
Other income from employment while not in a Rehab program

S.1527 would have more consistent benefits if it integrated with wages earned while working after disability and integrated with Workers Comp Benefits rather than being mutually exclusive.

III. The transition between the LTD Plan, the Pension Plan, and Social Security

The following chart illustrates the total income (1985 dollars) a claimant might receive as a percent of current income for various combinations of age at disability, duration of employment, and income combinations. Details of these numbers are found in the Appendix.

Type of Disability	Total Benefits (1) at Age			
	0 - 55	55 - 62	62 - 65	65+
Meets SS definition	60%	60%	22-87%	22-87%
Does not meet SS definition - Working	95%	55-85%	55-85%	12-75% (2)
- Not Working	40%	0-30%	9-65%	9-65%

(1) Total Benefit = LTD, SS disability, SS retirement, Federal Pension
(2) Will be higher if claimant also collects a private pension

Three observations emerge from the above chart:

(1) Generally, there is a smooth transition from disabled status to retired status and the benefits are consistent.

(2) Those individuals who do not meet the Social Security definition of disability and do not continue to work elsewhere suffer a significant temporary drop in income from ages 55 to 62. The termination of LTD benefits at age 55 for these individuals should be re-examined, as well as the reduction in benefits to 40%.

(3) Those individuals who do not meet the Social Security definition of Disability, but who continue to work in another occupation receive benefits close to those individuals who are disabled according to SS definition and will receive higher benefits if they accrue a pension in their subsequent job. This not only creates inequities, but contributes to the claim control problem discussed below.

IV. Claim Control

The ultimate difference in cost may vary by a factor of two between a plan with poor claim control and one with good claim control.

The approximate cost range of numbers for the S.1527 plan is $400-$800 million based on 1985 dollars, and all 2,500,000 federal employees covered. These numbers are on an incurred basis, and not on a paid basis, with the high number assuming little claims control and the lower number assuming effective claims control.

Good claims control is achieved by having a good plan and effective claim administration, not by denying meritorious claims. Effective claims administration means:

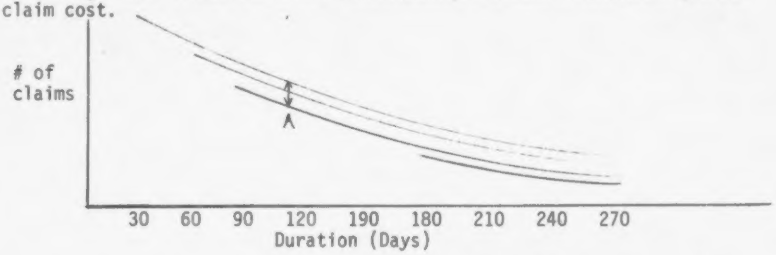
(1) approving and paying the proper claims
(2) working with the employer and disabled claimant to return him/her to work if possible
(3) denying un-meritorious claims
(4) proper controls to assure timely intervention when indicated

The following claims control features should be contained in an LTD Plan:

(1) Effective income replacement ratio
(2) Effective elimination period
(3) Effective definition of disability
(4) Rehabilitation programs

Elimination Period

The following chart illustrates the relationship between elimination period and claim cost.



As can be seen in the above chart, the cost at 120 days (point A) is higher for a 30 day plan than it is for a 90 day plan. This select experience continues for at least 5 years. The explanation for this difference is not a gap of coverage during the elimination period which could cause some individuals to return to work, since 95% of all claimants have income during that period, but rather is due to the re-examination and approval of the disability at the end of the elimination period along with new paper work and physical exams. If this plan's "end of sick leave" clause results in an average elimination period of less than 90 days, then significant cost savings could be obtained by reformating the program to have a weekly indemnity plan from the end of sick leave to 180 days, with the LTD starting at 180 days.

Income replacement ratios

Industry experience has shown that as the replacement ratios rise, so too does the incidence rate. To control claims, the total income after disability should be reasonable in relationship to that prior to disability. The relationship is reasonable except for those individuals who continue to work after disability under the 60% cap. The income they earn should be integrated on a dollar-for-dollar basis. Note that even with a dollar-for-dollar integration basis, such as possible pension accruals, Social Security credits and other fringe benefits, individuals still receive more benefits than if they choose not to work. These individuals are also prime candidates for the rehabilitation program discussed below.

Question: Does the 60% cap inflate at CPI-2%, or is it fixed at 60% of the original salary?

Definition of Disability

The proper definition of disability and its proper administration is critical to effective claims control. The Social Security Definition is tighter than that used in private LTD Plans. However, the "own occ" definition of S.1527 is so loose that it will result in a significant higher cost than could be obtained using the "own occ" definition of private plans. A proper "own occ" definition would result in providing reasonable benefits to those who could not work while encouraging those who could work to do so.

Rehabilitation Programs

Rehabilitation Programs are co-operative programs between the employers and their insurer which attempt to return to work those able to work. The program consists of any combination of the following for any individual:

(1) training in a new field
(2) job site or condition modification
(3) equipment purchases
(4) financial assistance
(5) counseling

From a societal and the individual's point of view, it is critical to return to work those able to work. Society's burden is reduced and the individual's income, self-reliance, and self-esteem are increased.

TPA Claims Administration

Third Party Administration of claims provides the purchaser with a proven set of guidelines and procedures necessary to insure proper adjudication of claims, as well as a trained staff capable of administering those guidelines and procedures. It is generally accepted as the most cost-effective method for a larger employer to insure an effective insurance program, short of setting up its own claim operation.

While the TPA approach is the most common form of claim adjudication for large employers, it does have some inherent problems. For the program to meet its objectives, tight controls are necessary for the Employer to insure that the proper balance between concern for employee welfare and cost effectiveness is maintained. One common problem encountered in TPA relationships centers around the effect of insufficient financial incentives on the administrator's aggressiveness in terminating benefits at the appropriate time.

Regardless of potential problems, the TPA approach would appear the most practical, especially if sufficient time is invested in the initial design and contract stages to identify the problems and to specifically address each one in the plan design and service contract.

V. Summary

In summary I recommend the following:

(1) Integrate with other income
(2) Provide LTD benefits if individual is receiving Workers Comp and integrate with those benefits
(3) Possible lengthening of the elimination period
(4) Tighten the "own occ" definition of disability
(5) Add a rehabilitation program
(6) Change the "own occ" benefit duration to age 62

For your information, I have enclosed a photo of an HIAA booklet which gives industry statistics on LTD.

In closing I would again like to say that I am honored to be asked to comment on this program. If we at Union Mutual could be of further service, either through written comment or in person testifying, please don't hesitate to contact us.

Nick Smith

Nick Smith, F.S.A.
2nd VP and LTD Actuary

cc: William V. Roth, Jr.

Appendix
Totally Disabled meeting SS Definition

Current
Age Band.
0-55

Benefits as a Percent
of current salary

		10,000				75,000			
Hire Age	Disability Age	LTD	Other Salary	Social Security (1)	Total	LTD	Other Salary	Social Security (1)	Total
20	22	60%-SS	-	SS	60%	60%-SS	-	SS	60%
20	54	60%-SS	-	SS	60%	60%-SS	-	SS	60%
45	54	60%-SS	-	SS	60%	60%-SS	-	SS	60%
47	54	60%-SS	-	SS	60%	60%-SS	-	SS	60%
52	54	60%-SS	-	SS	60%	60%-SS	-	SS	60%

55-62		LTD	Other Salary	Social Security (1)	Pension	Total	LTD	Other Salary	Social Security (1)	Pension	Total
20	22	60%-SS	-	SS	-	60%	60%-SS	-	SS	-	60%
20	54	60%-SS	-	SS	-	60%	60%-SS	-	SS	-	60%
45	54	60%-SS	-	SS	-	60%	60%-SS	-	SS	-	60%
47	54	60%-SS	-	SS	-	60%	60%-SS	-	SS	-	60%
52	54	60%-SS	-	SS	-	60%	60%-SS	-	SS	-	60%

62-65		Other Salary	Social Security (1)	Pension	Total	Other Salary	Social Security (1)	Pension	Total
20	22	-	45%	42%	87%	-	12%	42%	54%
20	54	-	45%	42%	87%	-	12%	42%	54%
45	54	-	45%	17%	62%	-	12%	17%	29%
47	54	-	45%	15%	60%	-	12%	15%	27%
52	54	-	45%	10%	55%	-	12%	10%	22%

65+		Social Security (2)	Pension	Total	Social Security (2)	Pension	Total
20	22	45%	42%	87%	12%	42%	54%
20	54	45%	42%	87%	12%	42%	54%
45	54	45%	17%	62%	12%	17%	29%
47	54	45%	10%	60%	12%	15%	27%
52	54	45%	0%	55%	12%	10%	22%

(1) SS Disability (2) SS Retirement

Disabled, not meeting Social Security Definition Works at 55% of Prior Earnings

Current Age Band. 0-55

Benefits as a Percent of current salary

		10,000			75,000		
Hire Age	Disability Age	LTD	Other Salary	Total	LTD	Other Salary	Total
20	22	40%	55%	95%	40%	55%	95%
20	54	40%	55%	95%	40%	55%	95%
45	54	40%	55%	95%	40%	55%	95%
47	54	40%	55%	95%	40%	55%	95%
52	54	40%	55%	95%	40%	55%	95%

55-62		LTD	Other Salary	Social Security (1)	Pension	Total	LTD	Other Salary	Social Security (1)	Pension	Total
20	22	-	55%	0	30%	85%	-	55%	-	30%	85%
20	54	-	55%	0	30%	85%	-	55%	-	30%	85%
45	54	-	55%	0	6.5%	61.5%	-	55%	-	6.5%	61.5%
47	54	-	55%	0	0	55%	-	55%	-	0	55%
52	54	-	55%	0	0	55%	-	55%	-	0	55%

62-65		Other Salary	Social Security (1)	Pension	Total	Other Salary	Social Security (1)	Pension	Total
20	22	55%	0	30%	85%	55%	-	30%	85%
20	54	55%	0	30%	85%	55%	-	30%	85%
45	54	55%	0	6.5%	61.5%	55%	-	6.5%	61.5%
47	54	55%	0	8%	63%	55%	-	8%	63%
52	54	55%	0	0	55%	55%	-	0	55%

65+		Social Security (2)	Pension	Total	Social Security (2)	Pension	Total
20	22	45%	30%	75%	12%	30%	42%
20	54	45%	30%	75%	12%	30%	42%
45	54	45%	6.5%	51.5%	12%	6.5%	18.5%
47	54	45%	8%	53%	12%	8%	20%
52	54	45%	0	45%	12%	0	12%

(1) SS Disability (2) SS Retirement

Disabled, not meeting Social Security Definition
Does not work

Current Age Band.
0-55

Benefits as a Percent of current salary

		10,000			75,000		
Hire Age	Disability Age	LTD	Other Salary	Total	LTD	Other Salary	Total
20	22	40%	0	40%	40%	0	40%
20	54	40%	0	40%	40%	0	40%
45	54	40%	0	40%	40%	0	40%
47	54	40%	0	40%	40%	0	40%
52	54	40%	0	40%	40%	0	40%

55-62		LTD	Other Salary	Social Security (1)	Pension	Total	LTD	Other Salary	Social Security (1)	Pension	Total
20	22	0	0	0	30%	30%	0	0	0	30%	30%
20	54	0	0	0	30%	30%	0	0	0	30%	30%
45	54	0	0	0	6.5%	6.5%	0	0	0	6.5%	6.5%
47	54	0	0	0	0	0	0	0	0	0	0
52	54	0	0	0	0	0	0	0	0	0	0

62-65		Other Salary	Social Security (2)	Pension	Total	Other Salary	Social Security (2)	Pension	Total
20	22	-	2%	30%	32%	-	.5%	30%	30.5%
20	54	-	35%	30%	65%	-	9%	30%	39%
45	54	-	35%	6.5%	41.5%	-	9%	6.5%	15.5%
47	54	-	35%	8%	43%	-	9%	8%	17%
52	54	-	35%	0	35%	-	9%	0	9%

65+		Social Security (2)	Pension	Total	Social Security (2)	Pension	Total
20	22	2%	30%	32%	.5%	30%	30.5%
20	54	35%	30%	65%	9%	30%	39%
45	54	35%	6.5%	41.5%	9%	6.5%	15.5%
47	54	35%	8%	43%	9%	8%	17%
52	54	35%	0%	35%	9%	0%	9%

(1) SS Disability (2) SS Retirement

Statement of Mr. J. Peter Grace
Chairman, President's Private Sector Survey on Cost Control,
Chairman and Chief Executive Officer, W. R. Grace & Co.,
Co-Chairman, Citizens Against Government Waste,
to the Senate Committee on Governmental Affairs, September 12, 1985

I appreciate the opportunity to comment on the Civil Service Pension Reform Act introduced by Senators Stevens and Roth. As you know, the President's Private Sector Survey on Cost Control (PPSS) was very much concerned with the pension systems of the Federal government, and devoted considerable effort to comparing provisions of the Civil Service Retirement System (CSRS) with those typically found in private sector retirement plans. I want to emphasize that our basis for recommending changes in Government systems and procedures was a detailed comparison to standard private sector practices. Our objective, therefore, in recommending changes to the CSRS was to ensure that the costs and benefits of that plan would be comparable to those of private sector plans.

We support in principle your initiative to reform the CSRS. The proposal (the Stevens-Roth bill) addresses many of the problems we uncovered in analyzing Federal retirement systems. For example, the Civil Service Pension System (CSPS) provides for reductions in pension benefits for retirement before age 62, benefits based on average salary over a five-year period, and cost-of-living adjustments (COLAs) which are less than fully indexed to inflation.

However, we do have reservations about the CSPS, because in certain areas, the proposal includes provisions which are not comparable to those found in the private sector and, in total, the CSPS would cost the Government more than is typical of the private sector plans. For example, the CSPS relies more heavily on a defined contribution plan than is standard in the private sector, and its total cost is from 2.5 to 6.8% pts. more than typical private sector pension plans (as a percent of payroll).

It is unclear to us why it is necessary to once again develop a unique pension plan for Federal civilian employees.

By way of background, on June 30, 1982, the President issued an Executive Order establishing PPSS. 160 individuals joined me in forming the PPSS Executive Committee. Most of the PPSS Executive Committee members, who collectively constitute a major segment of the business leadership of the United States, also served as Co-Chairmen of the Survey's individual Task Forces.

More than 2,000 volunteers worked on this 18-month study under the direction of the Executive Committee. Our findings were presented in 47 in-depth reports, which, including our final report to the President, totaled 21,000 pages, with an additional 1.5 million pages of supporting documentation. The private sector donated $76 million in cash, people, services, travel, and supplies -- the Survey cost the taxpayers nothing. I emphasize the scope of the Survey to make clear that our conclusions and recommendations reflect the concerted efforts and very hard work of dedicated professionals.

Our bottom line was 2,478 recommendations which, after full implementation, could save $424.4 billion over three years.

PPSS reviewed the costs and benefit levels of the CSRS and found that significant problems exist.

For example, when we compared the provisions of the CSRS with those typical of the private sector, we found that three major factors contribute to the higher benefit levels and the higher costs of the CSRS:

- Liberal Benefit Formula -- CSRS benefits are computed based on the high three years average salary versus high five years in the private sector, and the credit for service is about 40% greater in the public sector than in the private sector (1.7% per year in the public sector, after adjusting for employee contributions, compared to 1.2% in the private sector, after adjusting for the Social Security offset found in most plans).

- Retirement at an Earlier Age -- The most common retirement age is 55 in the civil service versus 65 in the private sector.

- Full Protection Against Inflation -- For example, from March 1977 to March 1982, COLAs averaged 9.2%/year for civil service pensions. This compares to an approximate 2%-3% increase for private sector pensions over this period.

As a result of these relatively liberal provisions, PPSS determined that lifetime CSRS benefits exceed those available under typical private sector plans, at typical retirement ages, as follows:

Lifetime Retirement Benefits
Assuming a Final Salary of $40,000,
30 Years of Service, and Typical Retirement Age

	Assuming Annual Inflation of:	(1) Civil Service with Retirement at Age 55	(2) Private Sector with Retirement at Age 65 (a)	(3) Civil Service as Multiple of Private Sector
(1)	5%	$1,096,128	$440,593	2.5X
(2)	7	1,446,326	478,359	3.0
(3)	9	1,931,153	524,127	3.7

(a) Includes Social Security.

At the most common age of retirement, the CSRS provides benefits approximately 2.5 to 3.7 times as great as those available under a private sector pension plan in combination with Social Security.

On the basis of these and other analyses, PPSS made the following recommendations to bring the provisions of the CSRS more in line with standard private sector practices:

- Increase the age requirement for unreduced pension benefits to age 62;
- Reduce benefits actuarially for retirement before age 62, with no voluntary retirement before age 55;
- Revise the benefit formula to define base earnings as the average of the highest five years of salary;
- Reduce the credit granted for each year's service to levels comparable to those in the private sector;
- Increase the service requirements for vesting in the CSRS from five to ten years;

- Decrease CSRS COLAs to reflect prevailing private sector practices; and

- Integrate CSRS with Social Security and eliminate provisions which allow "double dipping" (employees receiving two pensions, pay and a pension, or unreduced Federal pensions and full Social Security).

In total, PPSS recommendations would, after full implementation, reduce the normal cost accrual for the CSRS by $30 billion over a three-year period.

The relative generosity of the CSRS has been substantiated not only by PPSS, but also by other objective analysts. The table below compares the PPSS estimates of CSRS and private sector pension costs with those calculated by the consulting firms of Hay-Huggins and Towers, Perrin, Forster & Crosby:

(Table on following page)

CSRS Employer Costs as a Percent of Payroll

		(1)	(2)	(3)
			CSRS	
		Private Sector	Percent	As Multiple of Private Sector
(1)	Hay-Huggins	18.3%(a)	24.7%(a)	1.3X
(2)	Towers, Perrin, Forster & Crosby	17.0 (a)	28.3 (a)	1.7
(3)	PPSS	14.0 (b)	29.0 (c)	2.1

(a) Hypothetical costs based on economic and demographic assumptions developed by these consulting firms based on actuarial data provided by U.S. companies and the Office of Personnel Management (for the CSRS).

(b) Includes Social Security. Based upon the average of actual costs as reported by major U.S. companies.

(c) As reported by OPM in its 1983 annual report on the CSRS.

According to a Hay-Huggins study prepared for the House Committee on Post Office and Civil Service in December 1984, CSRS employer costs are 1.3 times those in the private sector (24.7% compared to 18.3%). In a study for the Office of Personnel Management, also in December 1984, Towers, Perrin, Forster & Crosby (TPF&C) determined that CSRS employer costs of 28.3% were 1.7 times those typical in the private sector of 17.0%. Based upon actual private sector costs and OPM data, PPSS determined that CSRS employer costs are 2.1 times those of typical private sector firms.

One of the alternatives to the present CSRS examined by TPF&C was the one proposed by PPSS. TPF&C determined that CSRS benefits exceed those available in the private sector, as follows:

Towers, Perrin, Forster and Crosby, Lifetime Retirement Benefits

		(1)	(2)	(3)
		Present Value of Lifetime Benefits		
	Age/Years of Service	CSRS	Private Sector	CSRS as Multiple of Private Sector
(1)	55/30	$240,680	$ 84,480	2.8X
(2)	65/40	207,020	123,640	1.7
(3)	65/30	150,920	109,120	1.4
		Percent of Payroll		
(4)	55/30	45.0%	15.8%	2.8X
(5)	65/40	29.5	17.6	1.7
(6)	65/30	26.0	17.3	1.5
(7)	Average	28.3%	17.0%	1.7X

According to TPF&C, the present value of CSRS lifetime benefits is 1.5 to 2.8 times those available in the private sector for the age/years of service characteristics listed above, with the average benefit 1.7 times as great.

According to TPF&C, if Congress were to revise the present CSRS along the lines PPSS recommended, the revised CSRS would compare to standard private retirement benefits and costs, as follows:

Towers, Perrin, Forster and
Crosby, Lifetime Benefits
PPSS Revised CSRS

		(1)	(2)	(3)
		Present Value of Lifetime Benefits		
	Age/Years of Service	CSRS	Private Sector	CSRS as Multiple of Private Sector
(1)	55/30	$ 82,280	$ 84,480	0.97X
(2)	65/40	138,820	123,640	1.12
(3)	65/30	109,340	109,120	1.00
		Percent of Payroll		
(4)	55/30	15.4%	15.8%	0.97X
(5)	65/40	19.8	17.6	1.12
(6)	65/30	18.8	17.3	1.09
(7)	Average	19.2%	17.0%	1.13X

On average, the PPSS-proposed CSRS would cost 19.2% of payroll compared to the 17.0% average in the private sector, 1.13 times as much.

TPF&C points out: "Generally, except for the absence of a supplemental defined contribution plan, the proposals of the Grace Commission are consistent or more liberal than is indicated by typical non-Federal retirement plan practices."

PPSS agrees that Federal employees should have a supplemental defined contribution plan -- typically a savings and investment (S&I) plan -- as is standard private sector practice. However, the cost of a three-tier pension plan (employer pension plan, Social Security, and savings and investment plan) should be consistent with comparable costs in the private sector.

The Stevens-Roth proposal would alter the current CSRS provisions in many ways which we feel would bring it more in line with standard private sector practices. We, therefore, support the proposal, which would establish a Civil Service Pension System, with reservations in the following two areas:

- The CSPS is, again, a unique system which is not comparable to typical private sector practices.

- The employer costs of the CSPS as estimated by the Congressional Research Service are 20.8%, which exceeds typical costs in the private sector, as shown by the PPSS, Hay-Huggins, and TPF&C studies.

The General Accounting Office (GAO) testified before the House Committee on Post Office and Civil Service on April 2, 1985, that the typical private sector retirement plan provisions are as follows:

> "-- Vesting, the point in time at which a participant has earned the right to a benefit, occurs at 10 years.
>
> -- Employees do not contribute to the pension plan.
>
> -- Age 62 is the earliest age at which employees receive pension benefits without reduction.
>
> -- Early retirement with reduced benefits is available at age 55 with 10 years of service. Benefit amounts are reduced by 4 percent for each year the retiree is under age 62.
>
> -- Pension plan benefits are based on the highest 5-year average salary.
>
> -- In recognition of the 'tilt' in social security benefits to lower income employees, pension plans are integrated with social security by offsetting the amounts the plan would otherwise pay by some portion of social security benefits.
>
> -- The 'typical' benefit formula ... is 1.5 percent of high-5 year average salary for each year of service less 1.25 percent times social security benefits for each year of service.
>
> -- Retirees' benefit amounts are actuarially reduced when survivor benefit coverage is elected.
>
> -- A separate long-term disability insurance program is provided in lieu of disability retirement.
>
> -- Periodic post-retirement adjustments average 40 percent of the increase in the Consumer Price Index. In larger plans (10,000 or more employees) adjustments average close to 60 percent."

The GAO has also determined (in its report of Feb. 26, 1985, "Benefit Levels of Nonfederal Retirement Programs") that typical private sector capital accumulation plans (savings and investment plans) generally provide for "a 50 percent employer match of employee contributions of up to 6 percent of pay."

These standards are almost identical to the PPSS proposals to reform CSRS provisions, and we find no compelling reason to formulate a plan which differs from these standards. The purpose of the Stevens-Roth bill is to provide:

> "...a stable and flexible retirement plan which is comparable to good private sector retirement benefits plans, enhancing portability of retirement assets between Federal jobs and jobs outside the Federal government, and ensuring a fully funded and financially sound Federal retirement program."

We feel the proposal substantially meets these goals, with the exception of comparability to the private sector.

The CSPS relies more heavily on a capital accumulation plan than is typical in the private sector.

Of particular concern in this regard, we feel that the CSPS may not provide adequate benefits to Federal employees who earn relatively low or moderate salaries. The CSPS credits Federal employees 1% for every year of service. This compares to 1.2% in private sector plans not integrated with Social Security. (The CSPS does not provide for Social Security integration -- i.e., a reduction in employer-provided pension benefits based upon Social Security pension payments.)

To compensate, the CSPS provides a defined contribution plan in which the Government will match 100% of employee contributions up to a maximum 5% employee contribution rate. As noted previously, typical private sector defined contribution plans provide a 50% employer match for employee contributions of up to 6% of salary.

The CSPS thus relies more heavily upon employee contributions than is standard in the private sector. Federal employees may not be able to participate in the CSPS defined contribution plan -- full participation in conjunction with Social Security would take 10.9% of an employee's pretax earnings, and for low- and moderate-income workers, this may represent an obstacle to participation.

This aspect of the proposed retirement system should be carefully considered, since approximately one-third of total CSPS pension benefits will come from the capital accumulation (defined contribution) provisions of the CSPS.

Our second concern is that the costs of the CSPS would be 20.8% of payroll, which are high in comparison to the standard costs in the private sector: Hay-Huggins, 18.3%; TPF&C, 17.0%; PPSS, 14.0%.

In summary, while we have reservations in terms of the plan's benefit balance (as between its defined benefit and defined contribution components) and its overall cost, we are generally supportive of the CSPS and the efforts of its sponsors to provide comparable retirement benefits to public and private sector employees.

I appreciate the opportunity to present our views on the CSPS, and we stand ready to provide any assistance or additional information which may prove useful in formulating your recommendations.

NATIONAL LEAGUE OF POSTMASTERS
OF THE UNITED STATES
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STATEMENT OF
R. FAIN HAMBRIGHT, PRESIDENT
NATIONAL LEAGUE OF POSTMASTERS
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
U. S. SENATE
HEARINGS ON S. 1527
CIVIL SERVICE PENSION REFORM ACT OF 1985

I AM R. FAIN HAMBRIGHT, PRESIDENT OF THE NATIONAL LEAGUE OF POSTMASTERS. OUR ORGANIZATION REPRESENTS MORE THAN 23,000 POSTMASTERS THROUGHOUT THIS NATION.

WE ALSO REPRESENT MORE THAN 50,000 OTHER FEDERAL EMPLOYEES AS ASSOCIATE MEMBERS ENROLLED IN OUR POSTMASTERS BENEFIT PLAN.

WE APPRECIATE THE OPPORTUNITY TO PRESENT TESTIMONY REGARDING S. 1527, THE "CIVIL SERVICE PENSION REFORM ACT OF 1985", A SUPPLEMENTAL RETIREMENT PLAN FOR POST-1983 HIRES, RECENTLY INTRODUCED BY THE DISTINGUISHED SENATOR FROM DELAWARE AND CHAIRMAN OF THE FULL COMMITTEE, MR. ROTH, ALONG WITH SENATOR STEVENS.

WE RECOGNIZE AND APPRECIATE YOUR PERSONAL EFFORTS MR. CHAIRMAN, AS WELL AS THOSE OF THE OTHER MEMBERS OF THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE AND THEIR STAFF WHO HAVE WORKED LONG AND HARD TO PRESENT A SUPPLEMENTAL RETIREMENT BILL WHICH WILL SATISFY ALL OF THE GOALS AND NEEDS WHICH HAVE BEEN IDENTIFIED BY ALL OF THE GROUPS CONCERNED, AND THAT THIS IS VIRTUALLY AN IMPOSSIBLE TASK. OBVIOUSLY, THERE WILL BE PROVISIONS OF ANY BILL WITH WHICH ONE OR MORE GROUPS WILL TAKE EXCEPTION.

WE THEREFORE PRESENT OUR COMMENTS AND CONCERNS WITH THE FULL AWARENESS THAT NOT ALL OF THEM WILL BE OR EVEN COULD BE MET BY THIS OR ANY OTHER BILL.

WE CONSIDER THE FEATURES AND PROVISIONS OF ANY SUPPLEMENTAL CIVIL SERVICE RETIREMENT PLAN WHICH IS ULTIMATELY ADOPTED TO BE CRUCIALLY IMPORTANT. NOT ONLY WILL THE SHAPE OF SUCH A PLAN AFFECT FUTURE FEDERAL EMPLOYEE ATTRACTION AND RETENTION, BUT IT VERY WELL MAY INFLUENCE ANY FUTURE CHANGES IN THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM. IN ADDITION, ANY PENSION PLAN ADOPTED BY THE FEDERAL GOVERNMENT WILL NO DOUBT PROVIDE A POSSIBLE MODEL FOR PRIVATE SECTOR AND STATE AND LOCAL GOVERNMENTAL PLANS.

BEFORE TURNING TO THE SPECIFICS OF THE STEVENS-ROTH SUPPLEMENTAL RETIREMENT PLAN, WE WANT TO STATE A FEW POINTS TO PUT THE DEBATE OVER THE MERITS OF THIS PARTICULAR PLAN IN CONTEXT.

WE THINK THAT IT IS VERY IMPORTANT TO REMEMBER THAT THE FEDERAL GOVERNMENT, IN ITS ROLE AS AN EMPLOYER, IS UNIQUE. ALTHOUGH IT IS USEFUL AND INSTRUCTIVE TO EXAMINE PRIVATE SECTOR PENSION PLANS, AND EVEN TO ADOPT VARIOUS OF THEIR INNOVATIVE AND SUCCESSFUL FEATURES, THE FEDERAL GOVERNMENT AND PRIVATE SECTOR EMPLOYERS ARE FUNDAMENTALLY DIFFERENT IN THEIR PURPOSES, GOALS AND MODES OF OPERATION.

THE FEDERAL GOVERNMENT PROVIDES MANY VITAL AND SOCIALLY BENEFICIAL SERVICES TO SOCIETY, DOES SO MAINLY THROUGH TAXPAYER FINANCING, AND DOES NOT OPERATE FOR PROFIT. THOSE CIVIL SERVANTS WHO WORK FOR THE FEDERAL GOVERNMENT DEDICATE THEIR CAREERS TO SERVING THE PUBLIC, OFTEN AT THE EXPENSE OF FOREGOING HIGHER MONETARY COMPENSATION AND BENEFITS AVAILABLE IN THE PRIVATE SECTOR. IN FACT, ACCORDING TO A RECENT STUDY BY THE HAY GROUP COMMISSIONED FOR THE HOUSE POST OFFICE AND CIVIL SERVICE COMMITTEE, FEDERAL EMPLOYEES, ON AVERAGE, FALL 7.2% BELOW WORKERS IN THE PRIVATE SECTOR WHEN BOTH PAY AND BENEFITS ARE COMPARED. THE ONLY ELEMENT OF THE TOTAL CIVIL SERVICE COMPENSATION PACKAGE WHICH IS COMPETITIVE WITH THE PRIVATE SECTOR IS RETIREMENT BENEFITS, WHICH ARE CURRENTLY 6.4% ABOVE AVERAGE PRIVATE SECTOR BENEFITS. HOWEVER, IF ONE COMPARES CSRS BENEFITS WITH THE BEST PENSION PLANS OF THE LARGEST CORPORATIONS, PAYROLL COSTS ARE ROUGHLY THE SAME - AROUND 25%. CIVIL SERVICE PAY IS 10.3% BELOW PRIVATE SECTOR PAY.

THE COMPONENTS OF CIVIL SERVICE RETIREMENT BENEFITS WHICH ARE CALCULATED TO BE AHEAD OF AVERAGE PRIVATE SECTOR BENEFITS ARE THE OPTION OF RETIREMENT AT AGE 55 WITH 30 YEARS OF SERVICE, AND THE 100% OF CPI COLA ADJUSTMENTS, BOTH OF WHICH ARE CONSTANTLY UNDER ATTACK. THE STEVENS-ROTH PLAN WOULD NOT LEAVE EITHER OF THESE COMPONENTS INTACT.

CONTRARY ASSERTIONS NOTWITHSTANDING, IT IS ABSOLUTELY UNTRUE THAT CIVIL SERVICE RETIREMENT IS "OVERLY GENEROUS" OR THAT CIVIL SERVANTS ARE OVER-PAID. WHILE VIRTUALLY NO PRIVATE SECTOR EMPLOYEES

CONTRIBUTE DIRECTLY TO THEIR BASIC PENSION PLANS, CIVIL SERVANTS CURRENTLY CONTRIBUTE 7% OF THEIR PAY TOWARD RETIREMENT. IT IS OUR FEELING THAT IT IS RIGHT AND PROPER FOR CIVIL SERVANTS TO CONTRIBUTE SOMETHING TOWARD THEIR RETIREMENT BENEFITS. BUT THESE BENEFITS SHOULD BE COMPREHENSIVE AND THEY SHOULD REPLACE AN ADEQUATE AMOUNT OF PRE-RETIREMENT SALARY TO ALLOW CIVIL SERVANTS THE DIGNITY AND SECURITY IN OLD AGE WHICH THEY HAVE EARNED. CIVIL SERVICE RETIREMENT IS NOT A "GIVE-AWAY" ENTITLEMENT PROGRAM.

A KEY DIFFERENCE BETWEEN CIVIL SERVANTS AND PRIVATE SECTOR EMPLOYEES IS THAT THE LATTER DO NOT HAVE THEIR PENSION BENEFITS USED AS A POLITICAL FOOTBALL EVERY YEAR. EARNED PENSION BENEFITS, INCLUDING COLAS, SHOULD BE VIEWED AS CONTRACTUAL OBLIGATIONS OF THE FEDERAL GOVERNMENT AS AN EMPLOYER. ATTRACTIVE PENSION BENEFITS HAVE BEEN AND SHOULD CONTINUE TO BE AN IMPORTANT ELEMENT IN RECRUITING AND RETAINING THE QUALITY PERSONNEL NECESSARY TO ASSURE THE CONTINUED AND SMOOTH FUNCTIONING OF THE FEDERAL GOVERNMENT. AS PREVIOUSLY NOTED, THE CIVIL SERVICE PENSION IS ABOUT ALL THE FEDERAL GOVERNMENT OFFERS WHICH IS COMPETITIVE WITH PRIVATE SECTOR COMPENSATION. IT SHOULD NOT BE MADE A SCAPEGOAT ON WHICH TO BLAME THE BUDGET DEFICIT OR USED AS A SOURCE OF "READY REVENUE" TO AVOID NECESSARY POLITICAL CHOICES ON TAXES AND SPENDING.

WE FEEL THAT THE CURRENT CSRS HAS BEEN A POSITIVE FACTOR IN ATTRACTING AND RETAINING QUALIFIED PERSONNEL, AND THAT IT HAS PROVIDED THE NECESSARY LEVEL OF RETIREMENT BENEFITS, AS WELL AS DISABILITY AND SURVIVORS BENEFITS, TO ASSURE SECURITY AND DIGNITY FOR

FEDERAL RETIREES AND THEIR FAMILIES.

ALTHOUGH WE ACCEPT THE NEED FOR A SUPPLEMENTAL CIVIL SERVICE RETIREMENT PLAN FOR POST-1983 HIRES, AND WE WANT TO WORK WITH THIS COMMITTEE TO ACHIEVE THE BEST PLAN POSSIBLE, THIS SHOULD NOT BE VIEWED AS AN OCCASION TO REDUCE COSTS RELATIVE TO THE CURRENT CSRS.

WE WOULD BE FORCED TO OPPOSE ANY SUPPLEMENTAL RETIREMENT PLAN FOR POST-1983 HIRES WHICH THREATENS THE FINANCIAL INTEGRITY, RULES AND PROVISIONS, OR CONTRIBUTION AND BENEFIT LEVELS OF THE CURRENT CSRS.

IT IS WITH THESE POINTS IN MIND THAT WE WISH TO ADDRESS THE STEVENS-ROTH SUPPLEMENTAL RETIREMENT PLAN UNDER CONSIDERATION HERE.

THE STEVENS-ROTH PLAN HAS MANY LAUDABLE GOALS AND FEATURES. THESE INCLUDE INCREASED FLEXIBILITY OF BENEFITS; BENEFIT PORTABILITY BETWEEN THE PUBLIC AND PRIVATE SECTORS; OPPORTUNITY FOR EMPLOYEES TO PARTICIPATE IN A VOLUNTARY DEFINED CONTRIBUTION THRIFT PLAN, AND TO DIRECT INVESTMENT DECISIONS; AND A WIDER DISTRIBUTION OF BENEFITS AMONG EMPLOYEES, INCLUDING SHORTER-TERM EMPLOYEES. WE ARE IN AGREEMENT WITH THESE ASPECTS OF THE PLAN.

WE HAVE NO ARGUMENT WITH THE BASIC TRIPARTITE STRUCTURE, ENCOMPASSING SOCIAL SECURITY, DEFINED BENEFITS AND A VOLUNTARY DEFINED CONTRIBUTION THRIFT PLAN WITH EMPLOYER MATCHING.

HOWEVER, WE DO HAVE SOME SERIOUS MISGIVINGS ABOUT PARTICULARS OF THE

PLAN ARRANGEMENT AND ABOUT BENEFIT ELIGIBILITY REQUIREMENTS.

FIRST, WE FEEL THAT THE EMPLOYEE CONTRIBUTION LEVELS BETWEEN OLD AND NEW EMPLOYEES SHOULD BE ROUGHLY EQUAL, AND THAT POST-1983 HIRES SHOULD CONTRIBUTE SOMETHING TOWARD THE DEFINED BENEFIT PORTION OF THE PLAN. THIS CONTRIBUTION COULD BE OFFSET BY ALL SOCIAL SECURITY TAXES PAID. FOR 1985, THE TOTAL CONTRIBUTION FOR ALL EMPLOYEES WOULD BE 8.35% OF PAY.

CONCURRENTLY, WE FEEL THAT THE DEFINED BENEFIT PORTION OF THE PLAN SHOULD BE CALCULATED USING A HIGHER FORMULA, PERHAPS 1.1% OR 1.2% OF THE HIGH-3 YEARS SALARY TIMES YEARS OF SERVICE. WE FEEL THAT IT IS IMPORTANT TO RETAIN THE HIGH-3 FORMULA, RATHER THAN A HIGH-5 FORMULA, BECAUSE USE OF THE HIGH-5 PARTICULARLY IMPACTS LOWER-PAID WORKERS AND WOULD TEND TO DECREASE INCENTIVES TO ADVANCE.

A HIGHER DEFINED BENEFIT PORTION IS VITALLY IMPORTANT TO ASSURE THAT, COMBINED WITH SOCIAL SECURITY, THESE TWO ELEMENTS WOULD PROVIDE AN ADEQUATE RETIREMENT BENEFIT FOR THE MANY CIVIL SERVANTS WHOSE SALARIES ARE TOO LOW FOR THEM TO TAKE ADVANTAGE OF THE THRIFT PLAN OPTION. FOR THOSE WITH HIGHER SALARIES, THE DEFINED CONTRIBUTION THRIFT PLAN WITH EMPLOYER MATCHING WILL COMPENSATE FOR THE SOCIAL SECURITY "TILT", AND WILL ALLOW THEM A GREATER DISCRETION IN THE AMOUNT OF SAVINGS AND TYPE OF INVESTMENTS THEY WANT.

ONE COMPELLING REASON FOR REQUIRING SOME EMPLOYEE CONTRIBUTION TO THE DEFINED BENEFIT PLAN IS TO DEMONSTRATE A DIRECT EMPLOYEE STAKE IN

THE LEVEL OF BENEFITS WHEN THE INEVITABLE POLITICAL ATTACKS ON "OVERLY GENEROUS" RETIREMENT BEGIN.

WE HAVE NO QUARREL WITH THE OVER-ALL VESTING PROVISIONS OF THE STEVENS-ROTH PLAN. WE ARE UNABLE TO SUPPORT, HOWEVER, THE SUBSTANTIAL REDUCTION FOR RETIREMENT AT AGE 55 WITH 30 YEARS OF SERVICE. A 14% REDUCTION IN ANNUITIES IS ALTOGETHER TOO HARSH A PENALTY FOR THOSE WHO HAVE LABORED SO LONG AND FAITHFULLY IN THE PUBLIC SERVICE. ADDITIONALLY, DUE TO THE FACT THAT SOCIAL SECURITY BENEFITS DO NOT BEGIN UNTIL AGE 62, AND ARE REDUCED IF TAKEN BEFORE AGE 65 (UP TO 20% FOR RETIREMENT AT 62), THE TOTAL LEVEL OF BENEFITS PAYABLE AT 55 WOULD ALREADY BE CONSIDERABLY REDUCED. IN REALITY, THE MAJORITY OF CIVIL SERVANTS DO NOT RETIRE AT AGE 55, BUT ON AVERAGE AT AGE 61, ROUGHLY THE SAME AS PRIVATE SECTOR EMPLOYEES. WE FEEL THAT THIS PENALTY IS UNWARRANTED, NEEDLESSLY ELIMINATES ONE OF THE ATTRACTIVE FEATURES OF THE CURRENT PLAN, AND THAT ITS' ADOPTION PUTS THIS OPTION IN THE CURRENT CSRS IN JEOPARDY.

FOR THOSE WITH UNDER 30 YEARS OF SERVICE WHO CHOOSE TO RETIRE AT 55, SOME REDUCTION IN ANNUITY WOULD BE ACCEPTABLE, ALTHOUGH WE FEEL THAT 5% A YEAR IS OVERLY HARSH.

WE FEEL THAT THERE IS SOME QUESTION AS TO THE EXACT FUNDING REQUIREMENTS FOR THE U.S. POSTAL SERVICE, DUE TO ITS SPECIAL STATUS AS AN INDEPENDENT AGENCY (OFF-BUDGET), AND ONE WHICH ALREADY CONTRIBUTES MORE THAN ANY OTHER AGENCY, ON A PERCENTAGE BASIS. WE WOULD OPPOSE PROVISIONS OF A SUPPLEMENTAL RETIREMENT PLAN WHICH

WOULD REQUIRE SUCH INCREASED CONTRIBUTIONS BY THE POSTAL SERVICE THAT A POSTAL RATE INCREASE WOULD BE NECESSITATED. CLARIFICATION IS NEEDED ON THIS POINT.

THIS BRINGS US TO WHAT WE FIND TO BE AN EXTREMELY UNCERTAIN ASPECT OF THE STEVENS-ROTH PLAN: THE ELECTION BY PRE-1984 EMPLOYEES TO PARTICIPATE IN THE NEW PLAN.

FIRST, AND FOREMOST, THERE SEEMS TO BE SOME DOUBT AS TO THE EFFICACY OF AMENDING THE SOCIAL SECURITY LAWS TO ALLOW INDIVIDUALS TO OPT INTO THE SOCIAL SECURITY SYSTEM. THIS IS WITHOUT PRECEDENT AND COULD POSSIBLY OPEN THE DOOR TO ENTIRE ADDITIONAL CATEGORIES OF FEDERAL WORKERS BEING FORCED INTO THE SOCIAL SECURITY SYSTEM. THIS LEGAL PROBLEM MUST BE SATISFACTORILY CLARIFIED BEFORE WE WOULD BE ABLE TO SUPPORT ANY VOLUNTARY ELECTION BY PRE-1984 EMPLOYEES TO JOIN THE NEW PLAN.

AN OPTION SHORT OF JOINING THE NEW PLAN MIGHT BE FOR ALL EMPLOYEES TO BE ALLOWED TO PARTICIPATE IN THE THRIFT PLAN, PERHAPS WITHOUT EMPLOYER MATCHING, AS WAS PROPOSED IN REPRESENTATIVE CHANDLER'S SUPPLEMENTAL RETIREMENT BILL.

ANOTHER ASPECT OF VOLUNTARY ELECTION TO SWITCH TO THE NEW PLAN IS THAT, OBVIOUSLY, THOSE WHO CALCULATE THAT THEY WOULD RECEIVE MORE BENEFITS UNDER THE NEW PLAN, RELATIVE TO COSTS TO THEM INDIVIDUALLY, DEPENDING ON THEIR FUTURE PLANS, WOULD WANT TO SWITCH. THIS WOULD LEAVE UNDER THE CURRENT PLAN THOSE WHO EXPECT TO COLLECT THE MOST

BENEFITS FOR THE LEAST COSTS. IN THE LONG RUN, THE COSTS OF BOTH SYSTEMS WOULD ALMOST CERTAINLY BE INCREASED.

IN SHORT, GRAVE QUESTIONS AS TO THE ADVISABILITY OF ALLOWING PRE-1984 EMPLOYEES TO SWITCH TO THE NEW SYSTEM REMAIN AND NEED TO BE ADDRESSED.

WE FIND THE STRUCTURE OF DISABILITY BENEFITS PROVISIONS OF THE STEVENS-ROTH PLAN TO BE ACCEPTABLE. VESTING AFTER 18 MONTHS SERVICE IS A WORTHY IMPROVEMENT TO THE CURRENT SYSTEM. HOWEVER, THE LEVEL OF BENEFITS IS REDUCED COMPARED TO THE CURRENT CSRS DISABILITY BENEFITS. FIRST, BENEFITS UNDER THE NEW PLAN ARE BASED ON HIGH-5, RATHER THAN HIGH-3 YEAR SALARY. MOST IMPORTANTLY, IN COMPUTING BOTH THE DISABILITY AND PROJECTED RETIREMENT BENEFITS, ANNUAL AVERAGE SALARY WOULD BE INCREASED BY 2% LESS THAN INFLATION. MEANWHILE, ANY SOCIAL SECURITY DISABILITY BENEFITS, INCLUDING COLAS, WOULD BE SUBTRACTED FROM DISABILITY PAYMENTS. WE FEEL THAT DISABILITY BENEFITS SHOULD BE FULLY INDEXED.

THE ISSUE OF CHOOSING A THIRD PARTY ADMINISTRATOR FOR THE PLAN SEEMS TO BE SOMEWHAT UNCLEAR, AND WE WOULD WANT A MORE DETAILED EXPLANATION OF WHY THIS STRUCTURE WAS ADOPTED.

IT IS IN THE AREA OF SURVIVOR BENEFITS THAT WE HAVE VERY SERIOUS RESERVATIONS AS TO THE ADEQUACY AND TIMELINESS OF BENEFITS. NEEDLESS TO SAY, THIS IS AN ISSUE OF GREAT CONCERN TO MANY WORKERS, PARTICULARLY THOSE WHO ARE THE SOLE SUPPORTERS OF THEIR FAMILIES.

THE ACTUARIAL FORMULA FOR DETERMINING THE JOINT-&-SURVIVOR ANNUITY IS NOT CLEARLY SPELLED OUT IN THE STEVENS-ROTH BILL. WE BELIEVE THAT EMPLOYEES ARE ENTITLED TO FULL INFORMATION AS TO EXACTLY WHAT BENEFITS THEY WILL RECEIVE AND WHAT FORMULAS WILL BE USED TO MAKE THESE DETERMINATIONS.

UNDER THE STEVENS-ROTH PLAN, A SURVIVING SPOUSE OF AN ANNUITANT WOULD RECEIVE ONLY 50% OF THE JOINT-&-SURVIVOR ANNUITY (WHICH INCLUDES A REDUCTION FOR EARLY RETIREMENT IF APPLICABLE), COMPARED TO 55% OF THE SURVIVOR ANNUITY UNDER THE CURRENT CSRS.

THE LARGEST DISCREPENCIES BETWEEN THE CURRENT CSRS AND THE STEVENS-ROTH PLAN ARE IN THE AREA OF PRE-RETIREMENT DEATH BENEFITS. THE PRE-RETIREMENT DEATH BENEFIT UNDER THE NEW PLAN WOULD BE ONLY 50% OF THE REDUCED ANNUITY (REDUCED FOR EARLY RETIREMENT AND FOR ELECTION OF JOINT-&-SURVIVOR ANNUITY), AND WOULD ONLY BE PAYABLE AT SUCH TIME AS THE EMPLOYEE WOULD HAVE BEEN ELIGIBLE TO RETIRE. THIS IS IN CONTRAST TO THE CURRENT CSRS BENEFIT WHICH IS 55% OF THE UNREDUCED ANNUITY PAYABLE IMMEDIATELY.

WHILE THE CURRENT CSRS PROVIDES FOR CHILD BENEFITS UPON THE DEATH OF AN EMPLOYEE, THE NEW PLAN WOULD NOT. IT RELIES HEAVILY UPON SOCIAL SECURITY SURVIVOR AND CHILD BENEFITS.

SOCIAL SECURITY SPOUSE SURVIVOR BENEFITS ARE ONLY PAYABLE TO A SPOUSE OVER AGE 59 IF A WORKER HAS 40 QUARTERS OF COVERED EMPLOYMENT. MOTHER'S AND FATHER'S BENEFITS ARE PAID AT ANY AGE IF THERE ARE

CHILDREN UNDER 18 AND A WORKER HAS 6 QUARTERS OF COVERED EMPLOYMENT. CHILDREN'S BENEFITS, PAYABLE IF A WORKER HAS 6 QUARTERS OF COVERED EMPLOYMENT, ARE PAID ONLY UNTIL A CHILD REACHES 18, AND NO LONGER CONTINUE WHILE A CHILD ATTENDS COLLEGE. A VERY IMPORTANT POINT IS THAT THERE IS AN OVER-ALL LIMIT, DETERMINED BY SALARY AND QUARTERS OF COVERAGE AT TIME OF DEATH, FOR TOTAL FAMILY BENEFITS.

THE NEW PLAN LEAVES A GAPING HOLE IN COVERAGE FOR MIDDLE-AGED WORKERS AND THEIR SPOUSES.

FOR A WOMAN WHO IS 45 YEARS OLD AT THE TIME OF HER SPOUSE'S DEATH, BUT WHOSE YOUNGEST CHILD IS 18, THERE WOULD BE VIRTUALLY NO COVERAGE WHATSOEVER FROM EITHER SOCIAL SECURITY OR THE SUPPLEMENTAL PLAN UNTIL THE DATE HER SPOUSE WOULD HAVE REACHED AGE 55. AND THE BENEFIT AT THAT TIME WOULD BE GREATLY REDUCED.

THE PROVISIONS FOR SURVIVOR BENEFITS, BUT PARTICULARLY FOR PRE-RETIREMENT DEATH BENEFITS, ARE UNACCEPTABLE IN OUR VIEW.

THERE SHOULD BE SOME LEVEL OF SURVIVOR BENEFITS PROVIDED TO THE SPOUSE AND CHILDREN OF EVERY WORKER WHO IS VESTED, AND THESE BENEFITS SHOULD BE PAYABLE IMMEDIATELY UPON THE DEATH OF THE EMPLOYEE.

OBVIOUSLY, SOCIAL SECURITY SURVIVOR AND CHILD BENEFITS DO NOT OBVIATE THE NEED FOR SUCH BENEFITS UNDER THE SUPPLEMENTAL CIVIL SERVICE RETIREMENT PLAN.

ALL VESTED FUNDS IN THE THRIFT PLAN SHOULD ALSO BE AVAILABLE IMMEDIATELY UPON THE DEATH OF AN EMPLOYEE.

ONE KEY OBJECTION WHICH WE HAVE TO THE STEVENS-ROTH PLAN IS THE REDUCTION IN COST-OF-LIVING ADJUSTMENTS FROM 100% OF C.P.I. INCREASE TO C.P.I. INCREASE -2%. THIS WOULD BE, AFTER A NUMBER OF YEARS, QUITE A SIZABLE REDUCTION IN BENEFITS, AS THE REDUCTION IS IN EFFECT COMPOUNDED EACH YEAR.

WE FEEL THAT ONE OF THE BEST ASPECTS OF THE CURRENT CSRS IS THE FULL COLA ADJUSTMENT. THIS IS AN AREA WHERE CIVIL SERVANTS ARE AHEAD OF THE PRIVATE SECTOR. ALTHOUGH SOCIAL SECURITY BENEFITS ARE FULLY INDEXED, THE IMPACT OF THIS REDUCTION WOULD MOST CERTAINLY BE NOTICEABLE. IT MUST BE UNDERSTOOD THAT, FOR THE AVERAGE ANNUITANT, PENSION BENEFITS ARE THE ONLY SOUCE OF INCOME IN A WORLD WHERE PRICES FOR VITAL GOODS AND SERVICES ARE CONSTANTLY INCREASING. MANY CURRENT CIVIL SERVICE PENSIONERS, EVEN WITH THE FULL COLA, ARE JUST ON THE BRINK OF POVERTY.

NOT ONLY WOULD REDUCING THE COLA AFFECT SUBSTANTIALLY THE SECURITY AND STANDARD OF LIVING OF FUTURE ANNUITANTS, BUT THE ADOPTION OF THIS PROVISION WOULD DOUBTLESS ENCOURAGE THOSE WHO CONSTANTLY CLAMOR FOR A COLA REDUCTION FOR CURRENT CSRS PENSIONERS.

WE CANNOT SUPPORT ANY REDUCTION IN COLAS.

ANOTHER ASPECT OF THE INDEXING PROBLEM IS THE CALCULATION OF

DEFERRED ANNUITIES. BECAUSE THE SALARY BASE USED TO DETERMINE THE LEVEL OF BENEFITS FOR THOSE ENTITLED TO A DEFERRED ANNUITY IS CURRENTLY FROZEN AT THE TIME OF SEPARATION, WHEN THE ANNUITY FINALLY BECOMES PAYABLE, IT WILL BE IN EFFECT REDUCED. WE WOULD FAVOR FULL INDEXING OF DEFERRED BENEFITS BETWEEN THE TIME OF SEPARATION AND PAYMENT.

WE ARE IN GENERAL ACCORDANCE WITH PROVISIONS RELATING TO THE DEFINED CONTRIBUTION THRIFT PLAN. HOWEVER, WE FIND THE LEVEL OF EMPLOYER MATCHING TO BE TOO HIGH. NOT ONLY IS THIS COSTLY, BUT IT BENEFITS ONLY THE RELATIVELY FEW HIGHER-SALARIED WORKERS WHO WILL BE ABLE TO AFFORD TO CONTRIBUTE. WE ADVOCATE A REDUCED LEVEL OF EMPLOYER MATCHING - SAY 50¢ FOR EACH DOLLAR OF SALARY CONTRIBUTED BY EMPLOYEES UP TO 6% OF PAY. THE INVESTMENT SELECTION AND REPORTING PROVISIONS SEEM ACCEPTABLE.

WE DO NOT FEEL THAT WE HAVE ADEQUATE TECHNICAL EXPERTISE TO COMMENT ON THE PROVISIONS REGARDING ADMINISTRATION AND OVERSIGHT OF THE THRIFT PLAN. HOWEVER, WE DO FEEL THAT STRINGENT ACCOUNTING AND REPORTING PROCEDURES MUST BE FOLLOWED AND THAT STANDARDS FOR PERMITTING INVESTMENT INSTITUTIONS TO PARTICIPATE MUST BE RIGOROUS. PERHAPS SOME FORM OF FEDERAL INSURANCE OF INVESTMENT FUNDS OUGHT TO BE APPLIED.

IN CONCLUSION, WHILE THE NATIONAL LEAGUE OF POSTMASTERS CONCURS WITH MANY ASPECTS OF THE PROPOSED SUPPLEMENTAL RETIREMENT PLAN, WE HAVE GRAVE RESERVATIONS ABOUT CERTAIN PROVISIONS. THESE INCLUDE

PROPOSED PROVISIONS WHICH WOULD: EXACT PENALTIES FOR "EARLY RETIREMENT" AFTER 30 YEARS OF SERVICE; PROVIDE NO EMPLOYEE CONTRIBUTIONS TO THE DEFINED BENEFIT PORTION; MANDATE INADEQUACY OF THE DEFINED BENEFIT PORTION OF THE PLAN; PERMIT ELECTION BY PRE-1984 EMPLOYEES TO PARTICIPATE IN THE NEW PLAN; PROVIDE INSUFFICIENT DISABILITY AND SURVIVOR BENEFITS; PROVIDE TOO GREAT A LEVEL OF EMPLOYER MATCHING FOR THRIFT PLAN CONTRIBUTIONS; AND LEGISLATE A 2% REDUCTION IN COLAS AND GENERALLY INADEQUATE INDEXING OF BENEFITS. THESE ASPECTS OF THE STEVENS-ROTH PLAN WOULD HAVE TO BE SUBSTANTIALLY MODIFIED BEFORE WE COULD POSSIBLY SUPPORT ITS ADOPTION.

ANOTHER CONCERN OF THE LEAGUE IS THE POSSIBLE ELIMINATION OF THE 401(K) PLANS THROUGH TAX REFORM LEGISLATION. THE COURTS HAVE RULED THAT BENEFITS PROVIDED AT THE TIME OF EMPLOYMENT ARE NOT GUARANTEED AN EMPLOYEE AT THE TIME OF RETIREMENT. WE THEREFORE ARE SUSPECT OF A PROPOSED TAX INCENTIVE THRIFT PLAN THAT APPEARS DESTINED FOR LEGISLATIVE SURGERY BEFORE THE FIRST EMPLOYEE DOLLAR IS CONTRIBUTED.

THE JULY 31, 1985 CONGRESSIONAL RESEARCH SERVICE REPORT TO THIS COMMITTEE PROVIDES COST ESTIMATES FOR ADDING OR SUBSTITUTING SELECTED PROVISIONS TO THE STEVENS-ROTH PLAN. THE COST OF PROVISIONS THAT WE HAVE ADVOCATED IN THIS TESTIMONY ARE ESTIMATED AS FOLLOWS:

DEFINED BENEFIT ACCRUAL RATE OF 1.1%	1.2%
FULL COLA	3.0
NO REDUCTION FOR RETIREMENT AT 55/30	0.5
HIGH-3 YEAR SALARY BASE	0.9
FULLY INDEXED LTD AND PROJECTED RET. BENEFIT	0.6
"UPPER-BOUND" SURVIVOR BENEFIT PACKAGE	0.3
FULL INDEXING OF DEFERRED BENEFITS	0.6
ADDITIONAL PAYROLL COSTS	7.1%
LEVEL EMPLOYEE CONTRIBUTIONS	1.1
50% EMPLOYER THRIFT PLAN MATCH TO 6% SALARY	1.6
TOTAL CHANGE IN PAYROLL COSTS	4.4%

WHEN ADDED TO THE ESTIMATED 20.8% OF PAYROLL COST OF THE STEVENS-ROTH PLAN AS IS, THE TOTAL COST OF A MODIFIED SUPPLEMENTAL RETIREMENT PLAN WHICH INCORPORATES ALL OF THE FEATURES WHICH WE SUPPORT WOULD BE 25.2% OF PAYROLL, VERY CLOSE TO THE COST OF THE CURRENT CSRS, ESTIMATED AT 24.7% OF PAYROLL BY THE CRS. THIS WOULD ALSO BE COMPARABLE TO THE COSTS OF THE BEST PRIVATE SECTOR AND STATE AND LOCAL GOVERNMENTAL RETIREMENT PLANS. WE DO NOT THINK THAT CIVIL SERVANTS, OR THE AMERICAN PEOPLE WHOM THEY SERVE, DESERVE ANYTHING LESS.

WE THANK SENATOR ROTH, SENATOR STEVENS, AND THE MEMBERS OF THE COMMITTEE FOR ALLOWING US THE OPPORTUNITY TO EXPRESS OUR CONCERNS.

WRITTEN STATEMENT FOR THE RECORD ON THE
ROTH-STEVENS CIVIL SERVICE RETIREMENT BILL

I am a federal employee, employed as a GS-12 electrical engineer by the Department of Energy in Bismarck, North Dakota, and have been a federal employee for over 9 years. I support the efforts to revise the present retirement system and look forward to being able to voluntarialy transfer to new plan. I wish to make the following comments;

1. Federal employees never should have been exempted from Social Security Coverage. This exemption has created a public perception that the retirement system that is forced on the general public is not good enough for federal employees. Federal employees would be better off under Social Security so that their supplemental retirement benefits could be directly compared to private industry plans.

2. The "thrift" savings plan is an excellent plan in line with the present trend of people saving and planning for their own retirement with IRA accounts and similar type plans. I would much rather have a retirement account with a known amount of equity than have an annuity which I may never collect.

3. There is one major difference between the original Stevens proposal and the present Roth-Stevens bill. The Stevens proposal would have allowed present federal employees to voluntarily transfer to the new plan and have all past contributions (employee, employer, and interest) placed in an IRA or similar type account. In contrast, the Roth-Stevens plan would force those voluntary transferring to "freeze" their civil service annuity account. This amounts to a forfieture of all benefits accrued prior to the transfer. I do not believe that there will be any value left from my 9 years contributions after the government has had 25 years to mismanage the account during periods of economic crisis. The government has no right to keep the money which was paid to an employee. A private employer would not be allowed to do that. I urge you to return the provisions to the bill which will allow employees to transfer their past retirement savings to an IRA type account.

4. The present Civil Service Retirement System is very unfair. It in effect says to employees;

> "If you quit you will only receive a small part of your annuity,
> and if you quit you most likely will not qualify for Social
> Security benefits, therefore you must work for the Federal
> Government until retirement wether you want to or not."

This constitutes a form of blackmale which should stop. Once federal employees are free from this situation their pay and benefits will equal that of private industry because the government will be forced to operate under the free market forces of supply and demand and compete with private industry for talent on an equal basis.

I urge you to proceed with the long overdue overhaul of the Civil Service Retirement System.

Richard H Hammond

Richard H. Hammond
Route 5
Bismarck, North Dakota 58501

NATIONAL ACADEMY
OF PUBLIC ADMINISTRATION
1120 G Street, N.W., Suite 540, Washington, D.C. 20005
202/347-3190

September 17, 1985

Mr. John Duncan
Staff Director
Committee on Governmental Affairs
United Stated Senate
Washington, D.C. 20510

Dear John:

As you requested by your letter of September 5, 1985, I have reviewed S.1527 with emphasis on the administration of the thrift plan provisions. It is clear that an enormous amount of highly professional work has gone into the development of this bill. I offer the following general observations:

a. Current tax reform proposals include possible elimination of 401(k) plans for the private sector. The government cannot, in my view, seriously propose a 401(k) type "Thrift Savings Fund" for federal employees while at the same time suggesting abolition of the program for those who now have it. If you proceed with the thrift plan feature, this dichotomy must somehow be addressed.

b. In the legislative history, some effort should be made to explain further the rationale briefly stated on Page 8 of Explanation for requiring all of the employee's thrift plan contributions to go into government securities for the first year, and all of the government's contributions to go into government securities for the first six years. You may face the charge that employees are being visited with reduced interest income in order to finance part of the National Debt.

c. The charts on pages 16 and 18 of Explanation indicate, if I interpret them correctly, that at the highest salary level in the proposed program an employee must take a 3.9% reduction in disposable income in order to stay even with the current program for retirement purposes. Coupled with a salary freeze for 1986, this will most likely be raised as an issue. Perhaps it is not of great significance at that income level, but I suggest the issue be dealt with squarely by the Committee in terms of the longer term interests of the SES.

With regard to administration of the thrift plan provisions, the composition of the Civil Service Thrift Investment Board may be perceived to be heavily weighted in favor of management (4 to 1), while the composition of the work force whose savings are to be invested most likely tilts in the opposite direction. Although the proposed Board composition may not be indefensible given the major roles of the executives named, it raises the possibility of an early PR problem -

and at the first sign of less than favorable ROI, could present the basis for a major management/employee collision.

Further, on this same point, appointment of a single labor organization representative by the President and subject to removal by the President could lead to enormous pressures and conflicts on that representative from all directions. The committee might wish to consider a larger Board with at least two labor organization members.

I believe the composition of the Civil Service Thrift Advisory Committee is basically sound and presents no great potential for difficulty. It also appears that appointment of the Executive Director and other staff outside the Civil Service laws is a good move since no personal benefit would accrue to them from decisions recommended or made.

At several points in the Explanation, comparisons in methodology are made with the private sector. This is certainly an enlightening thing to do, but it is important not to lose sight of the salary base upon which these systems are built. The total compensation comparability issue will continue to come up, and will become more pronounced as more private sector practices are employed. As you know, this is a highly complex area and there is no single answer. I trust the committee will keep it on the agenda. We have it on our agenda here at the Academy and are seriously pursuing it.

I appreciate the opportunity to present these views for consideration by the Committee prior to mark-up. As you requested, these are my personal reactions and do not reflect an official position on S.1527 by the Academy. Best wishes as your proceed. It is important that some form of retirement plan for new federal employees by enacted as soon as possible.

Sincerely,

Ray

Ray Kline
President

RK:tt

Statement on Civil Service Retirement System Reform
submitted to the
Senate Committee on Governmental Affairs

by
Herman B. Leonard
September 10, 1985

I am pleased to have this opportunity to submit testimony on the proposed reforms of the Federal Civil Service Retirement System (CSRS). I am Associate Professor of Public Policy at the John F. Kennedy School of Government, Harvard University. I teach public finance and financial management. Over the last several years I have conducted studies of the scope, character, and expense of the CSRS and the military retirement system. Last April, I testified before the House Armed Services Committee on the cost-effectiveness of the military retirement system. I am the author of the chapters on the civil service and military retirement systems appearing in two forthcoming National Bureau of Economic Research volumes on public sector compensation. I have just completed a book that deals extensively with public sector pension issues and related problems of public sector financial accountability.

The issues the Committee faces in redesigning the CSRS are complex and varied, and others have ably addressed many of the specific legislative questions before you. I would like to touch briefly on three points I believe are of central importance but often overlooked.

1. We cannot judge CSRS pensions solely by comparing them to other pension systems; the whole compensation package must be considered.

Much of the testimony you have heard in favor of CSRS reform is motivated by the belief that the CSRS is far too generous. In conjunction with the Social Security benefits for which many former federal employees also qualify, the CSRS provides a very high "replacement rate" -- that is, ratio of retirement income to pre-retirement annual earnings. This leads many observers to conclude that federal pensions are too large, and that they could safely be reduced. This argument is twice flawed.

Flaw 1: The argument is incomplete. The argument is based on an analysis of the pension part of compensation only. Pensions are an integral part of compensation, to be sure, but nevertheless only a part. We cannot judge whether the pensions part is too generous or too stingy without examining the rest of the federal compensation system. Basing a comparison on the pension component of earnings alone essentially assumes that all other aspects of compensation are identical -- a presumption that all respectable studies I know of refute categorically. Most studies of wage comparability -- which, by the way, make the same mistake of examining only a portion of the compensation package -- conclude that the wages of federal employees are lower than those earned by comparably trained private employees. That is particularly true in the upper management levels of federal service. The task of correctly comparing the total earnings of federal workers to private or other government employees is complex, and has not, to my knowledge, been satisfactorily completed. The essential point is that one cannot render a judgment about whether some workers are more generously paid than others merely by comparing their pension arrangements. Such comparisons are common, and sound as if they have immediate relevance to this legislation. They are, however, by themselves, misleading and out of place.

Flaw 2: The conclusion is backwards. There is no question that the CSRS provides higher benefits than typical private pension plans. In particular, federal plans are often criticized for being excessively indexed -- that is, for providing too much protection against future inflation. Private plans rarely provide anything like the full indexing enjoyed by federal retirees. But why should we assume that private plans are the right standard of comparison?

A simple arithmetic exercise demonstrates that most Americans save far too little for retirement. Consider an employee who will work from age 25 to age 65 and then enjoy 20 years of retirement. Suppose that he or she will earn enough interest on money saved for retirement to maintain the value of his or her investments after inflation and taxes. Even if the desired income in retirement is only two-thirds of pre-retirement earnings (protected from inflation), this individual should save one-third of his or her income each year for retirement. This is approximately the "funding rate" for the CSRS as it currently exists. A much lower funding rate will suffice if we don't care about protecting post-retirement income from inflation. But our capacity to adjust to inflation by additional earning ends at retirement. Who among us would want to retire on a fixed income, subjecting ourselves to constant worry about future inflation?

Rather than compare the CSRS to private plans and conclude that it is too generous, we might as easily ask why private plans are not _more_ generous. Obviously, they are not intended to be the sole source of income for private sector retirees. Still, even after we add Social Security benefits, most private retirement plans cover only the basics, particularly in the later years of life after inflation has eroded their only partially-indexed value. Indeed, the pressure to increase Social Security benefits to alleviate poverty among the elderly indicates that many Americans do not adequately prepare for their retirement needs. Since we cannot tell, without further analysis of the entire compensation package, whether federal workers are on the whole too well or too poorly paid, we cannot conclude that the CSRS system is too generous any more than we can conclude that the typical private system is too stingy.

What _can_ we conclude from comparing CSRS to private or other pensions? Though we cannot reach a conclusion about the _level_ of compensation by examining pensions alone, we can observe that the _composition_ of the federal compensation package is quite different from most others. Federal workers unquestionably are paid a larger fraction of their total earnings in the form of pensions. The composition of the federal package may, by itself, be a problem. Compensation paid in the form of defined-benefit pensions is less efficient and less accountable than compensation paid as wages. This is the best reason to endorse serious CSRS reform -- and it suggests that a defined contribution plan would be preferable.

2. Defined contribution pensions for public employees are better than defined benefit plans.

Whether or not the level of the current pension system is too high, its form is far from desirable. In spite of Congressional attempts to reduce CSRS underfunding, the system still tallies sizable but largely invisible annual deficits. The system has accumulated a considerable increment to the national debt. Few taxpayers are aware of its existence, let alone of its magnitude, now well over half a trillion dollars. The accumulation of this hidden liability is a form of quiet spending -- it takes place without appropriation, largely out of reach of our standard financial accountability mechanisms.

The lack of accountability of pensions spending is a compelling reason for reform. But spending in this form is also inefficient. Employees see it as compensation, but it is long deferred -- and, given Congressional consideration of legislation like that before you, it is risky. Employees therefore tend to value it at less than its true cost to taxpayers. Thus, pensions provided through the existing defined benefit plan are both hidden and wasteful.

Defined contribution plans, by contrast, are both visible and efficient. Both taxpayers and employees can immediately assess costs and value. While taxpayers may accept hidden costs like those flowing from defined benefit plans more easily than visible direct expenditures, in the long run hidden spending fosters poor government. The visibility of defined contribution plans to both taxpayers and workers is a considerable virtue even -- or perhaps particularly -- if it makes taxpayers more knowledgeable about the total federal compensation package. The direction in which this legislation proposes to move the CSRS, away from complete reliance on defined benefit arrangements and towards a mixed defined benefit and defined contribution plan, is a salutary first step.

3. The most difficult challenge of a federal defined contribution plan is to keep the asset-management policy decisions out of the political forum.

So long as the CSRS is on a defined benefit basis, funds can simply accumulate in the system's trust fund to pay future retirees. A defined benefit plan is the federal government's promise to pay a future pension, to be determined by formula at the appropriate time. The employee's claim is to the payment, not to the trust fund's assets. The assets are the government's money, a down payment on the liability. So long as the government is a net debtor, accruals to trust holdings simply reduce the outstanding government debt. The "portfolio" can be managed through the simple expedient of holding it in the form of special Treasury notes.

Managing the portfolio of assets held by a defined contribution plan is an entirely different matter. In a defined contribution plan, the worker's claim is to the assets and accumulating interest earnings on them. Accumulated contributions and earnings can be viewed as funds owned by the workers, held and managed by a trustee. In a system as large as the CSRS, the amounts involved will be enormous. The trustee(s) will be pressured to use these considerable funds for the owner-worker's advantage and to advance other worthy social goals. That pressure will ultimately land on the Congress.

This is the kind of political problem the Congress does not need more of. Small changes in the investment policies governing the massive assets that could accumulate under this plan could have dramatic effects on the prices of publicly-traded securities. Indeed, even rumors that the investment policy might be altered could be enough to send tremors through private capital markets. Every imaginable economic interest will petition the Congress for inclusion on the preferred investment list. Small businesses. Businesses in sunset industries that can be "saved" through recapitalization. Businesses in booming industries that need more capital. Businesses owned by women or members of ethnic minorities. Businesses that employ people in depressed areas. Businesses that believe they represent the future direction of the economy -- that is, nearly every business. All are deserving. How can any be refused?

Congressional involvement in the management of these assets would create many more political problems than it could solve. There is no end to the interests that could seek assistance. That is true of direct spending programs too. But unlike direct spending programs, here the resources seem unconstrained because they are not spent. When interests seek direct subsidies, they compete for limited available dollars within the appropriations process. In clamoring to be on the preferred investment list, they would only be competing for access to funds held in trust. The cost of reallocating trust funds is obscure because the true level of risk in investments is difficult to assess. Trust portfolio management thus presents a classic accountability problem -- benefits obvious to recipients with costs hidden from taxpayers. Congress has little to gain by inviting such a struggle on its doorstep -- particularly when the struggle would be over a considerable fraction of the liquid investable funds available in the entire economy, and could thus affect the overall level of economic activity and the sectoral pattern of growth and investment.

How can Congress endorse a pension plan that includes a defined contribution element and avoid the political minefield of being the court of last resort for divisive portfolio management questions? It could permit -- or require -- employees to name other trustees for their funds, the way private IRAs are operated. Federal employees would establish a private account under rules similar to those governing IRAs. The federal government would transfer funds directly to those accounts when the employee made a matching contribution. Alternatively, the government could arrange to have a portion of the employee's paycheck direct deposited in the account, along with the government's matching contribution. Such a transfer would be inexpensive and efficient -- and it would be happily accomodated by an increasingly competitive private financial system. Some oversight and regulation of financial institutions offering these accounts would be required to insure against fraud either of the employee or the government, and to make sure that funds designed to provide for retirement were not invested recklessly, but this could easily be tied to existing banking oversight and regulation functions.

This approach moves the trusteeship over the defined contribution assets one step away from Congress. The revised CSRS system currently proposed would continually confront the Congress with political pressures to modify its instructions to the trustees. Using a decentralized system like that proposed here, the Congress could avoid this constant no-win political battle.

Conclusion

The force behind changing the CSRS should not come from an unfounded claim that it is too generous -- and that claim is unfounded if it is sustained by examining only the pensions part of compensation. No careful comparison of total compensation has been carried out. The force for changing the system should flow instead from a belief that its form is inefficient and unaccountable. Whatever level of pension compensation -- or total compensation -- is decided upon, a defined contribution approach will increase the visibility of pension benefits both to taxpayers and to workers. Managing the defined contribution assets of the revised program through a decentralized system similar to private IRAs and Keogh accounts will avoid an intense, continuing, distracting, and costly political struggle from which the Congress stands to gain little.

September 13, 1985

John Thornton
410 Hummer Court
Sterling, Virginia 22170

Senator Ted Stevens
Chairman, Committee on Governmental Affairs
U.S. Senate Dirksen Office Building
Room 346
Washington, D.C. 20510

Re: S. 1527, Civil Service Pension Reform Act of 1985

Dear Chairman Stevens:

I very much regret that the Committee's schedule did not allow time for me to testify personally before the Committee. I am very concerned that your proposed revisions to the Civil Service Retirement laws could seriously and adversely affect the rights of employees in the high-stress positions, positions of air traffic controllers. Not only would this be unfair to the controllers, but, it could also endanger the safety of the air travelling public. I urge retention of the early retirement program currently provided for air traffic controllers in recognition of the severe stress demands of these positions.

I urge this Committee to review with care the enclosed documents, which I incorporate in my statement at this point.

Attachment (1) is a May 28, 1985 memorandum from the Federal Aviation Administration to all air traffic controllers reflecting that agency's strong position against extending by five years the required tenor for retirement. (Para. 3); and

Attachement (2) is the August 1985 House Subcommittee on Investigation and Oversight Report which discusses at length various studies, particularly the Rose Report (p. 34), entitled, Rebuilding of the Nation's Air Traffic Control System (Has Safety Taken a Back Seat to Expendiency?) relating to the stress upon air traffic controllers and their tendency for early burn-out. Neither of these phenomena are auger for an increased tenor requirement before full retirement. In short, the realities of air traffic controller employment do not support any increase in the years of service requirement to full retirement.

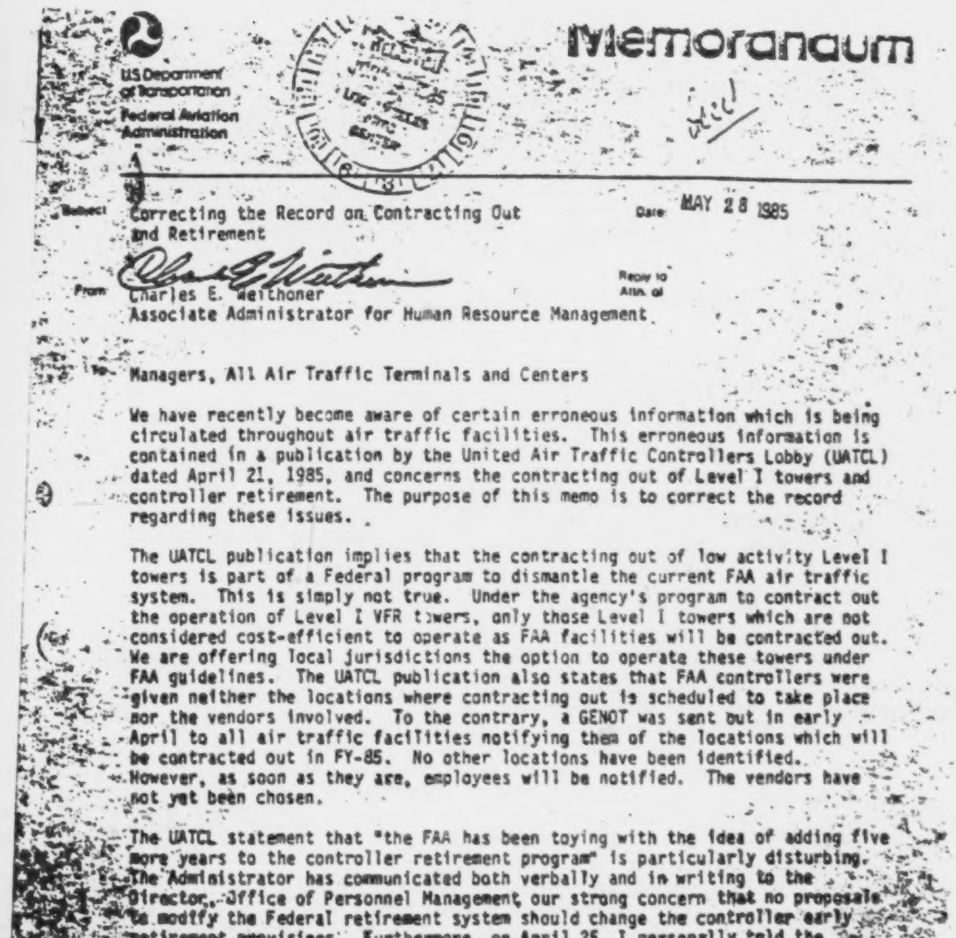
Time has not allowed us the opportunity of providing the Committee a complete analysis of the bill. We hope we will be allowed the opportunity.

Respectfully submitted,

John Thornton

John Thornton

*Attachment 2 may be found in committee files.



U.S. Department of Transportation
Federal Aviation Administration

Memorandum

Subject: Correcting the Record on Contracting Out and Retirement

Date: MAY 28 1985

From: Charles E. Weithoner
Associate Administrator for Human Resource Management

Reply to Attn. of:

To: Managers, All Air Traffic Terminals and Centers

We have recently become aware of certain erroneous information which is being circulated throughout air traffic facilities. This erroneous information is contained in a publication by the United Air Traffic Controllers Lobby (UATCL) dated April 21, 1985, and concerns the contracting out of Level I towers and controller retirement. The purpose of this memo is to correct the record regarding these issues.

The UATCL publication implies that the contracting out of low activity Level I towers is part of a Federal program to dismantle the current FAA air traffic system. This is simply not true. Under the agency's program to contract out the operation of Level I VFR towers, only those Level I towers which are not considered cost-efficient to operate as FAA facilities will be contracted out. We are offering local jurisdictions the option to operate these towers under FAA guidelines. The UATCL publication also states that FAA controllers were given neither the locations where contracting out is scheduled to take place nor the vendors involved. To the contrary, a GENOT was sent out in early April to all air traffic facilities notifying them of the locations which will be contracted out in FY-85. No other locations have been identified. However, as soon as they are, employees will be notified. The vendors have not yet been chosen.

The UATCL statement that "the FAA has been toying with the idea of adding five more years to the controller retirement program" is particularly disturbing. The Administrator has communicated both verbally and in writing to the Director, Office of Personnel Management our strong concern that no proposals to modify the Federal retirement system should change the controller early retirement provisions. Furthermore, on April 25, I personally told the Congressional Committee in charge of retirement legislation that early retirement for controllers must be retained with the present age and service requirements unchanged. This would be true of controllers covered by the "old" retirement system and those hired since January 1, 1984. There is absolutely no truth to the allegations that FAA is seeking to add five years to the controller retirement provisions.

The two programs I have discussed in this memo are of great concern to employees. That concern is made even greater when erroneous information regarding them is disseminated. Please share the correct information contained in this memo with all your employees.

STATEMENT FOR THE RECORD

AMERICAN ACADEMY OF ACTUARIES
SUBCOMMITTEE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS

TO THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE
HEARING ON CIVIL SERVICE PENSION REFORM ACT (S. 1527)

SEPTEMBER 13, 1985

The American Academy of Actuaries appreciates the opportunity to comment on proposed legislation to develop an appropriate new retirement system for those federal employees who are covered by Social Security. The Academy is a professional association of over 7,800 actuaries involved in all areas of specialization within the actuarial profession. Included within our membership are approximately 85% of the enrolled actuaries certified under the Employee Retirement Income Security Act of 1974 (ERISA), as well as comparable percentages of actuaries providing actuarial services for other employee benefit plans such as life, health, and disability programs. As a national organization of actuaries, the Academy is unique in that it includes actuaries with expertise in all areas of actuarial experience.

With respect to government relations, the Academy views its role as a provider of information and actuarial analysis in order that policy decisions may be made with informed judgment. It is our belief that the training and experience of Academy members allows for a unique understanding of current practices in employee benefits. It is our intention to communicate that understanding in ways that assist public policymakers. The following comments were developed by the Academy's Subcommittee on Public Employee Retirement Systems.

Our comments on the issues involved in creating a new civil service retirement system relate specifically to the Civil Service Pension Reform Act of 1985, S. 1527, introduced by Senators Stevens and Roth. A stated purpose of this act is to provide federal employees with a retirement benefits plan which is comparable to good private sector retirement plans. An indirect effect of the design of the new system may be to influence national retirement income policy.

In the private sector, retirement income is traditionally a three-legged stool -- Social Security, private plans sponsored by employers, and individual savings. The proposed configuration of a basic defined benefit retirement plan and a supplemental defined contribution thrift savings plan is consistent with emerging practice in the private sector.

The Academy notes that the proposed benefit formula of 1% of final five-year average salary times years of credited services does not take Social Security benefits into consideration. Such a non-integrated formula may be appropriate for government employees with relatively homogeneous salaries, but should not be implied as a standard for private sector plans where integration of plan benefits with Social Security could be more appropriate.

Regarding retirement age, it is said by some that the trends in retirement age will turn and that people will remain active at work well into their 60's. Certainly the 1983 Social Security amendments will encourage this trend. However, the current trend is still towards a lower retirement age. Whether this downward trend in retirement ages will reverse, and if so, what the timing and extent of any such reversal might be, is unclear at the present time. However, retirement ages have a major impact on the actuarial costs of retirement systems, both public and private. We note that unreduced retirement benefits at age 62 and the 2% per year reductions below age 62 for members retiring with 30 years of service is relatively liberal compared to private sector provisions for salaried employees.

Defined contribution plans are often used in the private sector as a supplement to defined benefit plans, and can be tailored to the current economic requirements of employees through salary reduction plans such as those under Section 401(k) of the Internal Revenue Code. The proposed plan incorporates such a component in its thrift savings plan. It is worth noting that the dollar-for-dollar employer match proposed in S. 1527 on the first 5% of member contributions to the thrift plan is relatively generous in comparison with general practice in the private sector.

Finally, we are pleased to note that a stated purpose of the act is to ensure a fully funded and financially sound federal government retirement benefits plan. Once the plan is in place, care must be taken to monitor the funding, and to ensure that the benefits do not become excessive. The membership of the Academy is uniquely qualified to provide input into this process. In the past, particularly during the debates surrounding the Social Security amendments of 1983, the Academy has acted as an objective, nonbiased provider of actuarial expertise. We would be happy to play such a role again in order to assist you in both the establishment of new retirement programs for new general federal employees, and in the ongoing process of monitoring these programs.

American Academy of Actuaries
Pension Committee
Norman S. Losk, Chairperson

Subcommittee on Public Employee
Retirement Systems
Donald M. Overholser, Chairperson

AARP

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before the

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

on

S. 1527 The Civil Service Pension Reform Act

September 13, 1985

American Association of Retired Persons 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700
Vita R. Ostrander *President* Cyril F. Brickfield *Executive Director*

AARP

SUMMARY STATEMENT
of the
AMERICAN ASSOCIATION OF RETIRED PERSONS
on the
Civil Service Pension Reform Act of 1985
September 13, 1985

AARP agrees that a three-tier plan, with a defined benefit component and a thrift plan supplementing Social Security, represents the best approach to providing adequate retirement income for newly-hired federal employees.

AARP believes that the defined benefit plan should be improved in order to provide better benefits to lower-paid employees. If meaningful increases in the benefit accrual formula are impractical for cost reasons, a small employee contribution should be considered.

Defined benefit income should be protected by a full cost of living increase. Anything less than a full COLA would have a significant impact on public and private sector retirement income security.

The thrift plan should be retained, however the employer match should be reduced. The Committee should explore the impact of requiring a 1.3 percent fully matched employee thrift contribution.

The benefits afforded survivors of newly-hired employees should be revised to insure adequacy and timeliness.

The special retirement provision for public safety officials should be revised to end discrimination against fit older employees.

American Association of Retired Persons 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700

Vita R. Ostrander *President* Cyril F. Brickfield *Executive Director*

The American Association of Retired Persons appreciates the opportunity to present for the record our views on the proposed Civil Service Pension Reform Act of 1985. AARP has among its almost 20 million members over one-half million federal retirees. As the nation's largest aging organization, AARP looks forward to working with this Committee to structure a retirement system for federal employees hired after 1983.

AARP commends Chairman Roth and Senator Stevens for their work in the development and introduction of S. 1527. We believe that this bill provides a good framework for the development of a new retirement plan. In particular, we agree that a three-tier system, utilizing a defined benefit plan and a capital accumulation plan in addition to Social Security, offers the maximum potential for retirement security for the widest number of employees.

AARP believes the ultimate standard against which any retirement plan must be judged is retirement income adequacy. Benefits should be adequate to provide for a secure retirement, and should be adequate at all income levels, particularly lower incomes. Benefits should also be adequately protected against inflation. Finally, the benefit structure should, on whole, provide benefits comparable to or better than those provided by the current plan and those offered by large private firms.

The development of a new federal retirement system is an issue of importance to all future retirees, federal and non-federal alike. This Committee has the unique opportunity to design a federal retirement plan that could serve as a model plan for the private sector. Thus, we urge the Committee to consider the impact of their actions not only on future federal retirees but also on future private sector retirement policy.

With these goals and concerns in mind we offer the following comments on specific aspects of the proposed Civil Service Pension System.

The defined benefit plan should be strengthened by providing for a full COLA and increasing the benefit accrual rate.

The proposed defined benefit plan would grant an annual cost living adjustment equal to the CPI minus 2 percentage points. Such an adjustment is inadequate for several reasons. First, the CPI minus 2 COLA will substantially reduce the value of the federal pension, particularly for older retirees. For example, after 10 years of 5 percent inflation, a retiree's defined benefit pension would equal only 80 percent of a fully indexed pension. After 20 years, the defined benefit pension would equal only 56 percent of a fully indexed pension. A pension benefit that will reward 20-year retirees with a 44 percent drop in purchasing power will not maintain an adequate income flow for those most in need of pension income. In order to maintain the value of pension benefits throughout retirement, AARP urges the restoration of a full COLA for the defined benefit plan.

Secondly, the partial COLA establishes a weak precedent for future inflation protection for all retirees. At present, inflation adjustments for private sector pensions are generally given only on an ad hoc basis, if at all, and are often less than necessary to compensate for inflation. As a result, private sector retirees receive, in real terms, diminishing pensions throughout their retirement. The federal government could provide federal retirees with a more secure retirement income stream by providing for a full COLA in the federal defined benefit plan. By demonstrating a strong commitment to retirement income protection, the federal government would help all current and future retirees.

As a final point, we oppose a CPI minus 2 COLA because of the precedent it may set for the Social Security COLA. While Social Security is a social insurance program--not a pension plan--some may see a reduced COLA as supportive of the notion that a less than full inflation adjustment provides adequate income protection.

The benefit accrual rate should be increased.

The proposal sets the pension formula at one percent of high-5 consecutive year earnings times years of service. This formula is significantly lower than that typical of plans in medium and large firms, and when combined with the early retirement penalties, results in relatively small pensions for many employees.

Although the defined benefit plan is not integrated with Social Security--a feature AARP strongly supports--the low accrual rate of one percent, coupled with the substantial early retirement penalties means that lower-paid employees will have little pension income with which to supplement Social Security. We recommend that the defined benefit formula be increased in order to provide better pensions for all employees. The Committee may wish to explore the use of an employee contribution of between 1 and 1.5 percent as a means of defraying costs.

The capital accumulation plan should be retained with a decreased employer match.

The proposal includes a voluntary capital accumulation plan that would supplement Social Security and the defined benefit plan pensions. Employees would be permitted to contribute up to 10 percent of their salary to the plan, with the first five percent fully matched by the government.

AARP agrees that capital accumulation plans are useful supplements to other retirement plans. Thrift plans provide incentives for savings among all employees, and allow higher-salaried employees to establish retirement income replacement ratios at levels comparable to lower-salaried workers. An additional virtue of thrift plans is portability. Thrift plans can be designed with short vesting requirements and rollovers of contributions into other tax-deferred accounts such as IRAs so that the short-term employee does not lose the tax advantages associated with maintaining a thrift plan.

AARP believes, however, that a thrift plan should provide a supplement to, and not substitute for, a good defined benefit plan. The proposed thrift plan, with its five percent full match is quite generous when compared to private sector plans. It can be expected that many high-income employees will take full advantage of the thrift plan. However, the costs of matching the contributions of higher-income employees must be examined in light of the less-than-generous defined benefit plan. Those individuals who are least likely to participate in the thrift plan--those making under $25,000 per year--are those who are generally the most dependent on the defined benefit plan for retirement income. For this reason we urge an expansion of the defined benefit plan and a reduction in the federal matching contributions of the thrift plan.

As an alternative to the above-suggested modifications to the defined benefit and capital accumulation plan, the Committee should study a mandatory employee thrift contribution.

We recognize that the recommended increase in the defined benefit plan formula will raise plan costs. These are, of course, limits on the allowable costs of the new retirement system. If it is certain that the defined benefit accrual rate cannot be substantially improved upon without increasing costs to unacceptable levels, we recommend that the Committee consider requiring a mandatory employee contribution to the thrift plan.

Under the present retirement system, federal employees contribute 7 percent of salary to the retirement plan and 1.3 percent to Medicare, for a total contribution of 8.3 percent of salary. Newly-hired employees will pay 5.7 percent of salary to Social Security, plus a 1.3 percent Medicare contribution, for a total 7 percent of salary. Thus, it is not unreasonable to suggest a mandatory employee thrift contribution of 1.3 percent. With a full employer match; this amount would provide a significant sum with which to supplement the defined benefit pension. To encourage the use of this income at retirement, we suggest that distribution rules penalize non-hardship early withdrawals, and that IRA-type rollovers be permitted in the event of pre-retirement termination of service.

As a final note, AARP recognizes that the Administration's proposal to abolish 401(k) plans may require the withdrawal of the thrift plan component of this plan. In that event the defined benefit plan formula should be modified to gradually increase benefit accruals as service increases.

The survivor benefit provisions of the proposal are inadequate.

The proposal makes significant changes in the benefits available to surviving spouses of civil service annuitants. While many changes reflect the assumption that Social Security will provide a basic survivor benefit, the proposed benefits as a whole will create hardships for many surviving spouses.

The current retirement system provides for an immediate 55 percent annuity for preretirement surviving spouses. The proposal replaces this with a 50 percent annuity, commencing on the date the annuitant would have been eligible to retire. The annuity would be reduced further if the annuitant was not eligible for an unreduced benefit. These changes--a reduced benefit and delayed payment--will deny surviving spouses, who are predominantly women age 45 and older, adequate amounts of income when it is needed the most. AARP urges the Committee to revise the survivor benefit provisions with income adequacy and timeliness given foremost consideration. Because the suggested survivor benefit revisions are not unduly expensive, and would prevent major hardships, the Committee should act to restore adequate benefits.

The proposed special retirement provisions for federal firefighting and law enforcement personnel constitute age discrimination.

The proposal retains the special retirement provisions for federal firefighters and law enforcement personnel. These employees face mandatory retirement at age 55, and are eligible for immediate retirement benefits after the completion of 25 years of service.

A deeply disturbing element of the early retirement scheme lies within the provisions limiting early retirement to certain classes of personnel. Specifically, those firefighters and law enforcement officers, the duties of whose position:

> "are sufficiently rigorous that employment opportunities are required to be limited to young and physically vigorous individuals, as determined by the Director considering the recommendation of the employing agency",

will be eligible for early retirement.

AARP has no argument with the notion that federal employees working for many years in hazardous service should be rewarded with an early retirement option. Rather, the Association strongly disagrees with the wording of the quoted provision, which implies that the trait of physical vigor is found only in young persons. Such an assertion furthers a stereotype of older persons as unable to perform effectively in the workplace, and ignores the fact that an individual's chronological age is not an accurate predictor of his or her ability to perform a given job.

Recent Supreme Court decisions interpreting the ADEA have made it clear that when an employer claims that persons over a particular age are unfit to perform a certain job, a factual judicial inquiry is necessary to ascertain that was impossible or impractical for the employer to conduct individualized determinations of fitness. While state and local law enforcement officers and firefighters have been afforded the coverage of the Age Discrimination in Employment Act (ADEA) and are protected against employment actions based on age stereotypes, the federal government has chosen to exempt its public safety officials from the Act.

This exemption is indefensible in light of medical evidence on the subject. A recent report by the House Select Committee on Aging examined available data and concluded that:

> "Mandatory retirement for competent law enforcement officers and firefighters is unnecessary and wasteful." The Myths and Realities of Age Limits for Law Enforcement and Firefighting Personnel, A Report by the Chairman of the Select Committee on Aging, 98th Congress, 2nd Session (1984).

We urge the Committee to consider the implementation of a retirement plan that would allow for early retirement for those public safety officers who so desire, while at the same time allowing qualified individuals to remain on the job. Given the recent advances in performance-based testing, the federal commitment to ending age discrimination and the positive experience of many states and localities that have replaced arbitrary age limits with carefully-crafted fitness requirements, it is imperative that the federal government reconsider its position that persons over 55 are unable to perform effectively as law enforcement officers and firefighters. At a minimum, the Committee should take this opportunity to seek out qualified medical opinion before perpetuating such an offensive form of discrimination.

Conclusion

The supplemental retirement system for newly-hired federal employees must focus primarily on retirement income adequacy, stability and security. Social Security will be a primary income source for many future federal retirees. Supplemental amounts provided by the defined benefit plan must be adequate, particularly for those with lower salaries, and must provide stability through full inflation indexing. The thrift plan, which is of great importance to higher-income employees, should be modified to be of greater help to lower-income workers. A small employee contribution to the retirement system should be explored if it is impossible to strengthen benefits otherwise. The survivor benefit provisions need to be reworked with adequacy and timeliness of benefits considered. Finally, the special retirement provisions should be modified to end the forced retirement of able employees. With these changes, the proposed retirement system will provide for economic security for future federal retirees.

Statement of the American Society for Public Administration

STATEMENT OF POLICY ON FEDERAL RETIREMENT SYSTEMS

Current legislation requires the design of a new retirement system by the end of 1985 for Federal employees hired after December 31, 1983. In addition, the Civil Service Retirement System for employees hired before 1/1/84 has been under intense scrutiny, making it possible that Congressional consideration of retirement matters will include this system as well.

As we do not know all the specific proposals for change that might be considered by the U.S. Congress, we will speak to general principles that we believe must be followed in constructing or modifying a Federal retirement system.

We believe that any Federal retirement system in order to attract and retain qualified employees must provide for adequate and equitable benefits to Federal retirees and their survivors and not be based on need. Further, any Federal retirement system should be designed for future stability to the maximum extent feasible.

The general principles which should be incorporated into the Federal employee retirement system follow:

1. Employees vested under the current retirement system should be permitted to remain in that system with the assurance that their current (or an equivalent) pension fund will exist upon retirement;

2. Any Federal system, taken as a whole, should be comparable to retirement systems in the private sector. For purposes of comparison, consideration of private sector retirement income must include Social Security, a private pension, capital accumulation plans (e.g.,401(k)), and deferred compensation.

3. If a Federal retirement system for new Federal employees is built around Social Security, the retirement system should also include a supplemental annuity similar to a private pension system, a capital accumulation plan, and deferred compensation. Any new system should be self-funding thereby avoiding unfunded pension liabilities. The supplemental annuity should be actuarially based and allowed to gain from investments derived from employer and employee contributions.

4. For retirees under the new system, cost of living adjustments should be built in;

5. Employees in the existing Civil Service Retirement System should be able to participate in a capital accumulation plan (e.g.,401(k)), preferably with employer contribution and deferred compensation plans;

6. A new Federal retirement system should facilitate participation by those in the existing system by providing opportunities for conversion to the new system; and

7. For those employees vested in the Federal retirement system who leave Federal service, they should as a minimum be able to take out their personal contribution to the retirement system with market rate interest (for the time periods involved). Such funds should be permitted to be rolled over into a personal retirement account.

A copy of this policy statement will be provided to the President of the Senate, Speaker of the House, chairs of the involved appropriations committees and the appropriate substantive authorization committees and involved agencies.

Adopted by Policy Issues Committee, August 2, 1985
Approved by National Council, August 4, 1985

STATEMENT
OF THE
ENLISTED ASSOCIATION OF THE NATIONAL GUARD
OF THE UNITED STATES

S.1527
CIVIL SERVICE PENSION REFORM ACT OF 1985

10 SEPTEMBER 1985

EANGUS
ONE MASSACHUSETTS AVENUE NW
WASHINGTON, D.C. 20001
ALAN D. OBERMILLER, EXECUTIVE DIRECTOR
TELEPHONE (202) 371-1856

Mr. Chairman and members of the Committee. The Enlisted Association of the National Guard of the United States is grateful for the opportunity to present our views on S.1527, the Civil Service Pension Reform Act of 1985.

We support the Congress and share in the desire to provide adequate defense at the lowest possible cost. Being a part of the "Total Force", we in the National Guard are proud of our accomplishments toward this end. At the heart of our ability to train and perform to the degree dictated by National Policy is the full-time employee.

S.1527 would substantially change the manner in which a part of that full-time force - the Civil Service Technician - would receive retirement benefits upon completion of career service. The unique requirement that the Technician must be qualified for, and a member of, a National Guard unit to qualify for Civil Service status must not be overlooked. We are not opposed to change for change sake, but we are ever vigilant for factors that would adversely affect our ability to perform as required. We believe that there are parts of S.1527 that should be considered in that context.

First, stretching out Civil Service unreduced annuity qualification to age 62, (bringing together all three "tiers" of the retirement package at that age), is counter to current military policy of maintaining a youthful force structure. Such a plan would require retaining military members to ages that are not compatible to many of the combat skills required on the modern battlefield. The age 62 criteria, if adopted for National Guard Technicians, would adversely impact on readiness and combat capability.

Secondly, the penalties imposed by S.1527 for retirement prior to age 62 are especially detrimental to military technicians. Selective Retention programs within the military community, designed to prevent an aging force, subject military technicians to involuntary early-out selection that, under S.1527 criteria, substantially reduce retirement income at an age that makes reentry into the job market most difficult.

Thirdly, we view investment of income for retirment as a highly speculative adventure - one fraught with peril uncertainty, and outside manipulation and influences - an option not necessarily conducive to providing dependable income over long term. While we are not naive enough to not recognize the possibilities for financial growth through investment programs, we cannot ignore the vagaries of such programs over the past decade, nor blind ourselves to the growing numbers of financial institution failures, bankruptcies and corporate fraud that have eroded confidence in investment markets. If the third tier is put into place, it must be crafted to insure that this part of the retirement income will not depreciate over time.

Fourthly, we must consider the proposal in light of attracting young, qualified, dedicated personnel into the full-time force to replace those lost through retirement. We must consider such questions as: Can we "sell" the critical need of early investment in a retirement plan to young people? Can we convince them that a career as a military technician will be rewarded with the same standard of living into retirement? Can we insure that there will be no adverse surprises in their retirement expectations decades into the future? Of course these questions do not have answers at this time, but we must pose them so that today's planning addresses tomorrow's concerns.

Having asked those questions, we are obligated to suggest some answers within the framework of S.1527. Our concept of the military technician within the Civil Service Reform Act of 1985 sees

- The military technician being included in the special category with firefighters, law enforcement officers and air traffic controllers due to the unique nature of the military technician occupation.

- Penalties imposed for early retirement be mitigated for those military technicians separated through involuntary separation programs designed to preclude an aging military force. We support no more than a 2% reduction for each year under age 55.

- If S.1527 is imposed on a military technician subject to aging restrictions in his military employment, a supplemental annuity benefit be provided until the individual qualifies for a full retirement at age 62.

- Individual investment into a "thrift plan" limited to those options providing maximum safety, a reasonable and predictable rate of interest, and indexed to cost-of-living cycles not subject to manipulation by future planners. This does not advocate built-in-raises, but insures that funds are managed according to fluctuations of future economies.

Mr. Chairman and members, we represent a group of people that are often overlooked and very often misunderstood when military costs are debated. The ENLISTED member does not command the highest salaries, nor represent the highest costs of retirement programs. Their compensation is on the lower end of the salary and retirement scale while representing the larger portion of the force. Our desire is not to perpetuate a program of unaffordable options, but to insure that the future of our country and the individuals who labor to that end are not sacrificed on the alter of cost-reduction unnecessarily or unadvisedly. We seek assurances that, whatever program is adopted, their future is secure.

The Enlisted Association of the National Guard of the United States wishes to thank the Chairman and members for considering our views. We stand ready to cooperate fully in working out details to S.1527 that would provide adequate protection and compensation to military technicians at reasonable cost.

STATEMENT OF THE
FEDERAL EXECUTIVE AND PROFESSIONAL ASSOCIATION
SUBMITTED TO THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
ON S. 1527,
A BILL TO ESTABLISH A NEW RETIREMENT AND DISABILITY PROGRAM
FOR FEDERAL EMPLOYEES HIRED AFTER 1983
SEPTEMBER 11, 1985

It is a privilege for the Federal Executive and Professional Association to provide a statement for this Committee on various issues raised by S. 1527 relating to the formulation of a retirement program for new federal employees.

We commend Senator Stevens for his leadership in introducing, with Senator Roth, S. 1527. The bill instantly brings the discussion of retirement issues into focus so that Congress, the federal employees, and the public can deal with them on a common basis.

At the outset, is should be remembered that the retirement program is but one element in the total compensation system for federal employees, which also includes pay itself, as well as other benefits such as disability compensation, health and life insurance, sick and annual leave, moving expenses, and travel costs. It is essential that the total compensation system be at least comparable to what the private sector offers, in order for the government to recruit, retain and motivate a competent workforce. Unfortunately, this comparability has been seriously eroded in recent years, with a consequent loss of many good people and a reduction in the efficiency with which the government functions. The American people are the losers.

The most important element of this total compensation system is pay. The studies by the Bureau of Labor Statistics of professional, administrative, technical and clerical pay in the private sector, the reports of the President's Pay Agent, and the studies by others show that federal pay consistently lags behind the pay of comparable positions in the private sector, particularly for the professional and executive personnel who provide the skills, the creativity, and the driving force to carry out the government's mission. We believe that federal pay should be fully comparable with the private sector. Until it is, we believe that is is absolutely essential that the serious lack of comparability be at least partially offset by making the retirement program for new federal employees at least as good as the best plans for large private organizations. This is particularly imperative in view of the fact that federal employees are unable to take advantage of many fringe benefits that are available to their counterparts in the private sector, such as bonuses, profit-sharing, stock-purchase plans, stock options, college scholarships, and so forth.

There are several principles that a retirement program for new federal employees should conform to:

1. The program should be fair to, and be perceived as fair by, the new employees, the current employees, and the public.

2. The program should preserve the integrity of the Civil Service Retirement and Disability Fund.

3. The program should compare favorably with the best plans in the private sector so as to meet the government's need to attract and retain quality employees.

4. The funding of the program should be free from political manipulation.

These principles are fully compatible with a three-tier retirement system for the new federal employees: The first tier is Social Security, which will provide the basic protection. The second tier is a supplemental defined benefits plan which together with Social

Security should provide most retirees and their spouses with an adequate level of replacement income for the retirement years. The third tier would be a voluntary thrift plan, supported by tax deferred status and agency contributions, for those who want to provide themselves with a better retirement income than the first two tiers make possible.

There are many ways the four principles affect the details of a three-tier program. The purpose of this statement is to set forth the views of the Federal Executive and Professional Association on some of the more important issues presented by S. 1527.

The Cost of the New Retirement System

We believe that the cost of the retirement system for new employees, measured as a percent of payroll, should be approximately equivalent to the cost of the retirement system for "current" employees. The placement of new hires on Social Security was not enacted by Congress as a cost-saving measure, but rather as a step to protect the Social Security Trust Fund. Consequently, that congressional action cannot be taken as a protest against the cost of the government retirement system nor as a commitment to lower that cost.

The government's cost, which is the government's contribution to the retirement program, is an element of the total compensation system. It would be unfair, and would be perceived as unfair, for two groups of federal employees--the old and the new--working side by side and being paid under the same pay schedule, to be receiving different compensation because the cost to the government of the three-tier retirement system for the new hires would be less than the cost to the government of the Civil Service Retirement System for those already on the payroll. Lastly, we have an inherent objection to singling out the federal employee for budget-cutting actions when so many other segments of our society who benefit from other government programs, particularly from federal tax expenditures, are not required to make equal sacrifices.

The Congressional Research Service (CRS) has estimated that the entry age normal cost to the government of the current Civil Service Retirement System (CSRS) is 24.7 percent of payroll, and that the entry age normal cost of S. 1527 would be 20.8 percent of payroll. In order to attain cost comparability, therefore, revisions should be made in S. 1527 that would change the payroll cost approximately four percentage points. Moreover, if changes are made in some features of the bill that reduce the government's cost, they should be offset by revisions in other features that increase the cost.

In general, the areas where we urge that improvements be made in order to attain cost comparability are in eliminating the reduction in the COLA below the full rate of inflation, increasing the government's match in the thrift plan, and increasing the defined benefits in the second tier by revising the formula to provide more than a 1 percent per year credit.

The Relationship of Second-tier Benefits to Social Security

The Congressional Research Service reports the following with respect to the integration of private pension plans with Social Security:

> "Most of the private sector plans included in the surveys are integrated with social security. For instance, the BLS data base shows that 64 percent of employees surveyed are covered by integrated plans. Other surveys show higher percentages of integrated plans

ranging from 66 percent to 96 percent." (Committee Print 98-17, at 45)

Describing a BLS study of 221 offset plans, the CRS further reports:

"About one-half the participants are in plans providing a benefit accrual of between 1.5 to 1.75 percent of final average earnings, with varying percent offsets of social security, for each year of service. Offsets between 1.25 and 1.67 percent are common." (Committee Print 98-17, at 230)

"Plans frequently place a cap on the percent of social security benefit which can be offset. The most common cap is 50 percent." (Committee Print 98-17, at 231, footnote 3)

We believe that the Congress should be guided by the practice in the private sector and incorporate an offset feature in the pension program for new federal employees. This offset provision is a response by private corporations to the realities of the marketplace in recruiting and retaining professional and executive employees. The Social Security benefits formula contains a pronounced tilt in favor of lower paid employees, as it properly should in view of its function as a safety net for all workers. But the function of a pension program is different--it is to provide retirement income at an adequate earnings-replacement rate for employees at all levels of pay. Achieving this result requires an offset feature for Social Security benefits.

Incorporation of an offset feature is particularly appropriate for the federal government because it depends so heavily upon professional and executive personnel to make its programs work successfully. These employees already are victims of pay discrimination relative to the private sector and to lower paid federal employees as the result of pay caps and pay compression. Their compensation package should not be further compressed by denying them an offset feature in their pension program in clear disregard of the private sector experience.

The selection of the proper offset formula requires further study. We believe it should be comparable to best plans for organizations in the private sector having a mix of professional, executive and other positions similar to those in the federal government.

Funding the Second Tier

It is essential to protect the financial integrity of the Civil Service Retirement and Disability Fund, from which the pensions of both current employees and new employees will be paid. It also is essential that the new pension program be funded properly to avoid the criticism that it amasses a large unfunded liability. Both of these objectives can be attained by the provisions in S. 1527 for full funding by the agencies of the accruing pension costs and for funding of supplemental costs as they arise.

Vesting

It has been our experience that the five-year vesting provision of the CSRS has been very satisfactory: It is long enough to test the employee's genuine commitment to the federal service, and short enough to provide both the psychic and potential monetary reward for that commitment. It would be destabilizing if the vesting period for the new employees were any longer or shorter,particularly in view of the fact that the Social Security benefits vest immediately. Although the typical vesting period for pension benefits in the private sector is ten years, Hay/Huggins has found that there is little cost difference between five and ten year vesting, and that for most designs under consideration, five year vesting will increase costs by less than .5 percent of pay over ten year vesting. For these reasons, we favor five year vesting for the new hires program.

The COLA

We are strongly opposed to the provision in S.1527 limiting the cost-of-living adjustment in annuities to the excess over two percent. The COLA should equal the full increase in the consumer price index.

There are several reasons for our opposition to this feature of the bill: The full COLA is an important feature of the current Civil Service Retirement System that often makes the difference between inducing superior professionals and executives to join and remain in the government workforce, and losing them to the private sector. Any reduction from a full COLA will result in severe erosion of the value of the government pension over time. It will be unfair and a source of discontment if the employees retired under the new system receive a lower cost-of-living adjustment in the pension portion of their retirement income than in the Social Security portion.

The argument that the federal COLA should be reduced because it is greater than the experience with private pension programs in recent years is unacceptable, because during this peiod the private pension funds built up considerable surpluses which could have been drawn upon to pay cost-of-living increases to the annuitants. Instead, corporate managers have systematically raided these assets by terminating the pension plans and diverting the surplus funds to the benefit of the officers and shareholders. Representative Roybal pointed out in an August 1, 1985 press release that "a total of 729 completed and pending plan terminations had already accounted for more than $6.7

billion in recaptured plan assets since 1980", and that this total would be swelled by an additional $962 million upon completion of United Airlines' announced plan to terminate the pension plans covering its employees and retirees. This scandalous example of corporate greed and social irresponsibility should not be advanced to justify denying federal retirees a full cost-of-living adjustment.

The Thrift Plan

The thrift plan in S. 1527 will give the new employees an opportunity to improve their retirement income by setting aside additional funds of their own in a tax-deferred, employer-supported savings program. Plans of this kind are very common in the private sector, and they are offered in addition to the defined benefit plans that are integrated with Social Security.

We support inclusion of a thrift plan in the new retirement program for new federal employees, because it is comparable to the private sector, encourages savings, and affords an option to those employees who wish to take advantage of it to increase their retirement income. It will be the only employer-supported capital accumulation plan available to the federal employees, in contrast to employees in the private sector who also enjoy stock-purchase, stock option and similar plans. We think the employee contribution that is matched by the government could appropriately be increased and that it should be increased if the percentage of the government contribution is reduced below one-to-one, as some suggest. Also, it has been recommended that the tax deferral feature should be eliminated because the Administration has proposed that section 401(k) tax-deferred savings plans be eliminated. This would be unfair to federal employees. They should not be singled out for discriminatory treatment. There is no certainty that tax revision legislation will be enacted, or if it is, that the 401(k) feature will be eliminated. Federal employees should be treated no less favorably than the private sector.

The Defined Benefits Formula

The factor in the defined benefits formula of one percent of salary per year is well below the private sector average. It should be raised to at least 20 percent above the private sector average in order to compensate for the fact that federal pay is consistently determined to be 20 percent below the private sector.

Survivor Benefits

The old saying that "two can live as cheaply as one" means that if one of the two dies, the expenses of the survivor do not diminish appreciably. This is as true during the retirement years as it is during the working years. The only option available for survivor benefits under the present Civil Service Retirement System provides the survivor only 55 percent of the retiree's unreduced annuity. This often works a hardship on the survivor, because her (or his) costs usually do not decline proportionately when the annuitant dies. The proposal in S. 1527 to allow the survivor only 50 percent of the actual annuity is even worse. The bill should be amended to allow the retiree the option of reducing the primary annuity in order to increase the survivor's annuity to as much as 100 percent of the retiree's annuity. This will not cost the government any money but will allow greater flexibility in providing for both the retiree and the survivor in their old age. The same option should be provided under the current system as well.

Administration

We recommend that an annual report on both the existing civil service retirement program and the new pension program, and on the Civil Service Retirement and Disability Fund, be furnished to all federal employees. They have a vested interest in the management and integrity of these programs and should be informed about them in order to protect this interest.

The Unified Budget

The Civil Service Retirement System and the new civil service pension program should be removed from the Unified Budget at the same time as Social Security is removed, for the same reasons.

In conclusion, we appreciate the opportunity to submit this brief statement on the issues we have discussed. We further commend the Committee for the thorough, professional and open manner it is undertaking the difficult task of formulating a supplemental retirement program for federal employees hired after 1983. It is a matter of considerable importance to the Nation that the task be performed well, because the future viability of our way of life depends to an important degree on the ability of the government to recruit, retain and motivate a competent workforce to accomplish the missions of the federal government.

Federal Law Enforcement Officers Association
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DATE:
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TESTIMONY BY
SA THOMAS DOYLE
FLEOA NATIONAL EXECUTIVE VICE PRESIDENT
AND LEGISLATIVE CHAIRMAN
ON
THE PROPOSED NEW CHAPTER 84, TITLE I, UNITED STATES CODE,
"CIVIL SRVICE PENSION SYSTEMS"
BEFORE THE COMMITTEE ON GOVERNMENT AFFAIRS, U.S. SENATE
SEPTEMBER 10, 1985

"A Professional Association for Federal Law Enforcement Officers"

Mr. Chairman, Senators, it is indeed a pleasure to be able to comment on changes to federal law enforcement retirement systems included in the proposed new Chapter 84, Title I USC, "Civil Service Pension System."

Federal retirements and cost-of-living adjustments have been of great concern to members of the Federal Law Enforcement Officers Association and to all federal law enforcement officers for some time.

On March 28, 1983, when the Federal Law Enforcement Officers Association met with then-Presidential Advisor Edwin Meese III, we spoke at length about the fears agents and other enforcement personnel had regarding modification of the "6(c)" retirement; reductions in COLA's; and the inclusion of federal officers in the Social Security system.

In 1984, when a group of our national officers met with Mr. Stephen Galebach, Special Assistant to Mr. Meese, these concerns were again spoken of at length. Finally, last week, a delegation met with Attorney General Meese once more and expressed its concern over raising the retirement standard to 55 years of age and 25 years of service, and cutting COLA's to the CPI less 2%.

Quite honestly, gentlemen, we fear both for the current federal law enforcement officer and his/her family and for the nation. We say this because it is our firm opinion that tampering with the federal law enforcement retirement system, today, will have a damaging effect on federal enforcement and the federal criminal justice system at least until the next century.

Altering federal retirements for law enforcement officers by raising the retirement age to 55 years of age and 20 years of service, curbing COLA's to the CPI less 2%, and reducing pensions by 5% per year for each year a person retires prior to age 55 would eliminate important economic incentives needed to draw qualified young personnel into federal enforcement and keep them there for 20 years.

Crime in the United States today, is one of the primary concerns, if not the primary concern of most citizens. Fighting crime at the federal level requires a young, vigorous work force. In the past that work force was attracted in large measure by a favorable pension system offered to career federal enforcement officers. With the changes you have proposed the pension incentive to enter and stay in federal service is drastically reduced. At present, pay, benefits and pensions for federal law enforcement and major city police departments are roughly comparable. But when one considers the reduced costs of living and lifestyle stability enjoyed by local enforcement personnel, the federal system is actually offering less than its big city counterparts.

For example, a federal officer with a four year college degree enters the federal government as a GS-1811 Criminal Investigator and serves his training period and first year as a Grade 5 making a base pay of $14,390. When you compare this with the minimum pay for patrolmen in cities with populations over 250,000, that starting salary is quite low.

Chart A which follows takes the minimum patrolmen's pay for 37 cities and compares it to the $14,390 per year starting salary of a GS-5. The figures on starting patrolmen's salaries were obtained from the Fraternal Order of Police's Survey of 1983 Salaries and Working Conditions of Police Departments in the United States, published on March 15, 1983. You can see from Chart A just how low federal starting salaries are by comparison. On average, they are $3323.18 below the starting salaries of patrolmen.

CHART A

CITIES WITH POPULAIONS OVER 250,000	MINIMUM PATROLMEN'S SALARIES	GS-5 SALARY $14,390	AMOUNT PATROLMEN'S SALARIES EXCEED GS-5 SALARIES
Chicago, IL	20,106	14,390	+5716
Detroit, MI	19,983	"	+5593
Houston, TX	20,550	"	+6160
Los Angeles, CA	23,343	"	+8953
Philadelphia, PA	18,374	"	+3984
Baltimore, MD	15,608	"	+1218
Cleveland OH	18,521	"	+4131
Columbus, OH	13,998	"	- 392
Dallas, TX	20,448	"	+6058
Indianapolis, IN	14,401	"	+11
Jacksonville, FL	16,054	"	+1664
Memphis, TN	14,664	"	+274
New Orleans, LA	16,044	"	+1654
Phoenix, AZ	18,949	"	+4559
San Francisco, CA	24,821	"	+10,431
Washington, DC	18,551	"	+4151
Atlanta, GA	15,700	"	+1310
Austin, TX	17,988	"	+3598
Birmingham, AL	16,000	"	+1610
Charlotte, NC	15,487	"	+1097

Chart A - continued

CITIES WITH POPULAIONS OVER 250,000	MINIMUM PATROLMEN'S SALARIES	GS-5 SALARY $14,390	AMOUNT PATROLMEN'S SALARIES EXCEED GS-5 SALARIES
Cincinnati, OH	22,183	"	+7793
Corpus Christi, TX	16,560	"	+2170
El Paso, TX	14,829	"	+439
Kansas City, MO	16,584	"	+2194
Louisville, KY	14,102	"	-288
Miami, FL	20,675	"	+6285
Montgomery, AL	10,817	"	-3573
Nashville, TN	14,376	"	-14
Newark, NJ	18,911	"	+4521
Norfolk, VA	12,696	"	-1694
Oakland, CA	24,096	"	+9706
Oklahoma City, OK	16,934	"	+2544
Omaha, NB	19,200	"	+4810
Pittsburgh, PA	18,797	"	+4407
Portland, OR	19,280	"	+4890
St. Louis, MO	16,328	"	+1938
Toledo, OH	19,450	"	+5050

Now if career advancement is rapid, a federal officer becomes a journeyman criminal investigator after five years and will earn a base pay of $31,619 at the GS-12 level. This is where most officers spend their careers. When we compare this to the maximum salaries patrolmen can earn in the 37 cities with populations cited in the Fraternal Order of Police survey we find that journeymen agents' salaries exceed patrolmen's salaries, but not by enough to compensate for the following factors. Federal officers overtime is regulated by AUO provisions and capped at $6003.00. Patrolmen earn time-and-a-half as scheduled overtime. Federal officers pay for mortgage changes that occur due to transfers around the nation. Local officers stay in one location and in many cases complete their mortgage payments at the time of their retirement. Federal officers lose spouse incomes as a result of movements around the country and, they lose again when moving from low cost, medium sized cities to major, high-cost metropolitan areas around the nation.

You will see what we mean when you look at Chart B. When you average the difference between the maximum patrolman's salary and the GS-12 salary you find the GS-12 only earns an average base pay that is $8,202.89 per year more than the patrolman's. This means that federal officers handling international and interstate crimes, possessing at least a four year college degree, investigating white collar crimes in the millions of dollars, and protecting domestic and foreign dignitaries actually wind up with a buying power that is less than that of the big city patrolman.

CHART B

CITIES WITH POPULATIONS OVER 250,000	MAXIMUM PATROLMEN'S SALARIES	GS-12 SALARY $31,619	AMOUNT GS-12 SALARIES EXCEED PATROLMEN'S MAXIMUMS
Chicago, IL	27,600	31,619	+3819
Detroit, MI	26,398	"	+5021
Houston, TX	26,229	"	+5190
Los Angeles, CA	34,118	"	+2499
Philadelphia, PA	20,895	"	+10,524
Baltimore, MD	19,356	"	+12,063

Chart B - continued

CITIES WITH POPULATIONS OVER 250,000	MAXIMUM PATROLMEN'S SALARIES	GS-12 SALARY $31,619	AMOUNT GS-12 SALARIES EXCEED PATROLMEN'S MAXIMUMS
Cleveland OH	22,277	"	+9142
Columbus, OH	21,985	"	+9434
Dallas, TX	24,792	"	+6627
Indianapolis, IN	20,663	"	+10,756
Jacksonville, FL	22,596	"	+8823
Memphis, TN	19,696	"	+11,723
New Orleans, LA	26,136	"	+5283
Phoenix, AZ	26,811	"	+4608
San Francisco, CA	28,736	"	+2683
Washington, DC	26,714	"	+4705
Atlanta, GA	19,700	"	+11,719
Austin, TX	26,640	"	+4779
Birmingham, AL	20,000	"	+11,419
Charlotte, NC	21,792	"	+9,627
Cincinnati, OH	24,700	"	+6719
Corpus Christi, TX	20,220	"	+11,199
El Paso, TX	17,166	"	+14,253
Kansas City, MO	27,102	"	+4,317
Louisville, KY	17,368	"	+14,051
Miami, FL	27,726	"	+3693
Montgomery, AL	13,941	"	+17,478
Nashville, TN	19,248	"	+12,171
Newark, NJ	20,596	"	+10,823
Norfolk, VA	16,836	"	+14,583
Oakland, CA	29,040	"	+2,379
Oklahoma City, OK	20,734	"	+10,685
Omaha, NB	23,160	"	+8,259
Pittsburgh, PA	23,262	"	+8,157
Portland, OR	28,184	"	+3235
St. Louis, MO	20,358	"	+11,061
Toledo, OH	25,569	"	+5850

Currently, however, the fine federal retirement for law enforcement officers makes up for this. In the retirement area, federal law enforcement officers can leave the government at age

50 with 20 years of service and receive a pension equal to 50% of their high three years. After 25 years they can go out at 60%. After 30 years of service they are able to leave at 70% and after 35 years they receive 80% pensions. All pensions are fully indexed to the Consumer Price Index, and it only takes five years to become vested. Since this pension system has been in effect it has insured young persons come in and stay in the federal law enforcement. It has allowed senior personnel to leave at an age where they can take on second careers and continue to contribute tax dollars on income and pension earnings. This pension system has attracted and held men and women in law enforcement despite stress, dislocation, danger, intangible problems and long after the romance of being a federal criminal investigator had worn away. And, it is this very effective tool that your plan proposes to change.

Your COLA proposal would set the cost-of-living adjustment at the CPI less 2% This in reality means that over the course of 20 years, given a minimum inflation rate at, or greater than 2% per year, the purchasing power of a federal officers pension would decline 40% or more. Since computation of pensions may soon be based upon the high five years of service, not the high three, the COLA reductions mean even a greater cut in pension income. Finally, proposed penalties for early retirement -- and 5% per year for each year under age 55 -- and raising the minimum age for retirement to 55 could reduce a federal law enforcement officers pension to as low as 25%. In our opinion this makes little sense at all.

So far, the economic advantages in the current "6(c)" retirment have outweighed such things as children being removed from schools and separated from friends. It has outweighed spouses separation from neighbors and relatives. It has even outweighed the psychological impact of knowing that the first move during a career is to be only the first of several. We believe, however, that the changes you propose will tip the scales in the other direction.

As for raising the retirement age from 50 years of age to 55, it is difficult to imagine a 55 year old man or woman working surveillance at irregular hours under arduous conditions. It is difficult to see 55 year old men and women running along side motorcades on protective assignments. It is difficult to imagine 55 year old men and women taking part in a buy-bust narcotics situation. Both job effectiveness and personnel safety mitigate against raising the retirement age. Moreover, raising the minimum retirement age will almost guarantee that more persons retire on disabilities than currently are doing so.

The current pension system offers federal enforcement officers and their families some clear protection against the vagaries of the countries economic ebb and flow. It reduces the stresses that federal enforcement families must live with and on which their decisions to stay or leave federal service are partly based. That is why we ask you not to change the pension system that currently is in force.

But why is this so important? Why should the special agent or the federal enforcement officer be different than other special classes of federal employees?

The answer is both a practical and a philosophical one. The basic function of the federal government is to provide for the safety of the American people. Without a vibrant federal enforcement arm, one that reflects the education, attitudes, opinions, and values of the American people, the federal government cannot accomplish its duty.

Interstate and international crime can neither be uncovered nor investigated without a large, capable federal enforcement arm. The coordination of some 17,000 state and municipal police organizations becomes impossible without a stable federal law enforcement arm. And indeed, the prosecutorial, and judicial legs of the federal criminal justice would lose their strength if they could not depend in large measure on the federal law enforcement agencies and officers for continuity.

But for federal enforcement to shoulder this responsibility it must attract a young, vibrant, well educated workforce, train that force, and have it committed to giving 20 years of service.

Under the current federal enforcement system, Assistant U.S. Attorneys come into government for a few years, get credentials, build a reputation, and leave for lucrative private practices of law. Federal enforcement officers hold the system together. But, take away the economic incentive, and it is our belief that special agents, and federal enforcement officers too will enter for a few years, develop their credentials and leave for equivalent salaried stable posts in local or state law enforcement, or lucrative private security positions. This revolving door syndrome will impact not only on federal enforcement, but on liaison between federal enforcement activities and those at other levels of state and municipal government.

In the late 1960s and early 1970s the United States experienced the problem of having its law enforcement organizations at great oddds with the changing attitudes and values of the nation. It has taken 20 years to begin turning that around. The changes came because a new cadre of young, bright professionals were brought into the expanding federal enforcement establishment and with them came new ideas. Today attempts to hold down costs by cutting the federal law enforcement retirement system will do away with the very economic incentives that brought these kinds of competent people in and kept them in federal criminal justice. Moreover, it is not hard to hypothesize what the personnel impact of these cuts will have a few years hence. It will mean that those who chose to stay in federal enforcement, despite the economic disadvantages will be neither the best nor the brightest. Good personnel will come in, gain experience and credentials and leave. Because of this attrition, undistinguished careerists will eventually rise and become senior management. Since the full extent of the problem would not be felt for 5 years and legislative remedy could not begin to take effect for 5 more years, federal law enforcement would labor under inferior calibre personnel for at least a decade.

We in FLEOA find this possibility frightening and we do not believe our national safety could tolerate a decade of this kind of deterioration.

In concluding our comments we want to tell this Committee that we appreciate the terrible pull and tear between competing worthwhile endeavors that must be funded with an ever shrinking pool of financial resources. But if protection of the nation against foreign enemies is the first duty of federal government, then insuring the public safety and order must surely come second. As such we strongly urge you to leave the federal law enforcement retirement system at 50 years and 20 years of service and leave COLA's at full index to the CPI.

Statement of the

Fund for Assuring an Independent Retirement
(FAIR)

to the

Senate Committee on Governmental Affairs

on

S-1527
Supplemental Retirement Plan

Submitted 9/24/85

EXECUTIVE SUMMARY

This FAIR analysis is a technical paper designed to probe the impact of key OPM, GAO, CRS, and other actuarial reports on the deliberations of this Senate Committee in considering S-1527. It is submitted by FAIR to supplement the record rather than restate the positions advanced by many of its coalition members in the September 9-11, 1985 Senate hearings. Below is a summary of this statement.

1.) The Office of Personnel Management study, "Review of Non-Federal Retirement Practices and Costs," is flawed, producing information which is more representative of small private sector retirement plans than those for the larger plans with which the federal government is in competition for employees. This FAIR analysis carefully assesses the impact of the report's methodological flaws on its findings of COLA recapture rates - both ad hoc and automatic - determined by OPM to be prevalent in the private sector. FAIR concludes that the findings of OPM's report understate the actual private sector COLA adjustments by more than 65%.

2.) The most comprehensive study done to date assessing ad hoc and automatic COLA increases for retirees was conducted for the Department of Labor by researchers at North Carolina State University. This study found that, on average, all retirees in the smallest through the largest plans averaged recovering approximately 38% of the increase in the Consumer Price Index between 1973 - 1979 which the study encompassed. However, workers covered by larger plans, those covering 10,000 workers or more, which would be competitive and more comparable to the federal sector pension systems, recovered fully 57% of the inflation increases over this time period.

3.) The same study discovered that collectively bargained pension systems have better ad hoc and automatic cost of living coverage for their retirees than do non-union plans. The recapture rate for large union plans was 66.7% and for large non-union plans averaged 43%.

4.) FAIR strongly recommends that the percentage of payroll costs determined for "representative" private sector plans by the Congressional Research Service and the Hay/Huggins study be recomputed. These plans were evaluated assuming only a 30% recapture rate of inflation for private sector retirees covered by these representative plans. In contradiction to the findings of the North Carolina University researchers, the 30% was not increased for the more expensive costing figures for the top quartile and upper 10% of retirement plans.

5.) FAIR maintains a more appropriate assumption for the recapture rate would be the 57% found by the North Carolina

University study. Furthermore, this study was strongly endorsed by the General Accounting Office and the Congressional Research Service as the most comprehensive study undertaken on this issue to date. The report notes that its methodology would, because of three different factors, tend to be conservative and understate rather than overstate the actual recapture rates.

6.) The actuarial costing estimates by the CRS and Hay/Huggins derived as a percentage of payroll the cost of three "representative" private sector retirement systems. The average was 18.3%, the third quartile 21.4% and the upper 10% was 25.1% of payroll. Each of these determinations, however, assumed a COLA recapture rate of only 30%. FAIR urges this Senate Committee to request that these "representative" plans be reevaluated assuming 57% catch up of COLA rather than the 30% figure.

7.) FAIR estimates, without access to the actuarial models used to derive these costs, that the impact of using the higher recapture rate would be to increase these pension plan costs as a percentage of payroll from about 1.5% to upwards of 3%.

8.) FAIR urges that these additional costs previously not considered in the debate over the design of a new federal and postal retirement system for post 1983 employees be taken into account. This should impact the current floor rate of S-1527 established as 20.8% of payroll and revise the floor rate for consideration of S-1527 to at least 22.8% to 23.8% of payroll. Further, this means that the 10% best retirement plans on average have an employer cost of approximately 28.1% of payroll and are substantially better than the existing CSRS with an employer cost of only 24.7%.

9.) The FAIR study finds that an evaluation of a retirement plan as a percentage of payroll is valid for comparability analysis of retirement systems only if the base payroll levels are also comparably determined. The pay comparability gap determined by Hay/Huggins of 10.3% will by FY '86, according to the FAIR analysis, increase to 16.6%. This means that federal employees' pay in FY '86 will be only 85.8% of a fully comparable pay base.

10.) Fringe benefits considered as a percentage of payroll are eroded by a pay comparability gap. This diminshed value applies to the current retirement system which is measured as a percentage cost of payroll. The CSRS employer cost cost of 24.7% is diminished to only 21.2% of a comparability payroll. Similarily, if S-1527 is amended to recommend a retirement plan costing the employer 25% of current payroll by FY '86, it would only be worth 21.5% of a payroll established to close the pay comparability gap.

The Fund for Assuring an Independent Retirement (FAIR) is pleased to have this opportunity to submit for the record a statement on Senate Bill S-1527 and its impact on FAIR coalition members. The purpose of this statement is not to reiterate the separate testimony by many of our coalition members, but rather to supplement that testimony on specific areas that we feel need to be augmented in the record.

FAIR is concerned that conclusions drawn from the Office of Personnel Management (OPM) study entitled "Technical Support in the Development of Modification to Civil Service Retirement System" may be accepted without consideration of the weakness in the research methodology used to arrive at their conclusions. Accordingly, FAIR will describe and assess the study's research methodology.

At this time, emphasis will be placed especially on the impact that procedural weaknesses have on the study's determination of private sector retirees COLA adjustments. The substantial understatement of retirees COLA catch-ups will in turn be shown to produce undervalued "representative" private sector pension plans.

OPM Study Methodology

The OPM study, "Technical Support in the Development of Modifications to the Civil Service Retirement System," analyzes information taken from the ICF retirement plan provision data base.[1] It is stated to be representative of retirement plan provisions in the nonfederal sector. The data base contains primary and supplemental retirement plans of each of 325 sponsors having a total of 475 retirement plans. The excess of retirement plans over sponsors is derived from the fact that the primary and the supplemental plans are separately categorized. According to this study, in 1982 there were over 600,000 employer-sponsored retirement plans in the United States. The ICF analysis is derived from 1981 form 5500 data tapes.

Their study was stated to have ". . . stratified on the basis of industry, type of sponsor (single vs. multi-employer) and sponsor size." The study goes on to indicate "the ICF first divided the universe of nonfederal retirement plans into three sectors: 1. public sector plans; 2. multi-employer plans in the private sector; and 3. single employer plans in the private sector. These three divisions capture all but the Keogh plans which would be generated in self-employment situations and which were not included in the ICF analysis."

The actual development of the sample design was achieved by ICF by first obtaining from the Department of Labor an edited data base which contained information on all single employer plans that filed form 5500 reports in 1981.

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[1] Towers, Perrin, Forster & Crosby, and ICF Incorporated, Technical Support in the Development of Modifications to the Civil Service Retirement System: Task I - Review of Non-Federal Retirement Practices and Costs, Contract No: OPM-18-84, August 1984, Chapter I and Chapter II.

> "ICF then edited the data base and combined all the plans that each sponsor maintained. ICF then classified the sponsors by industry and then sorted the sponsors in each industry by size of plan sponsor. A random stratified sample of plan sponsors was then selected from each industry. ICF stratified the sample by plan size so that the sample would include a higher proportion of large sponsors than small sponsors (emphasis added)."

Initially the emphasized aspect of the quotation above would seem to indicate that the ICF study was weighted towards the larger plans as opposed to the smaller plans. However, the inclusion of a higher proportion of larger sponsors is a very misleading statement. There are fundamentally two ways to stratify and draw a representative sample from different retirement plans. One would be considering the number of plans and the other would be considering the number of participants. If one chooses the first course, which is what this OPM study did, there are obviously many more small plans than there are large plans. However, one large plan, such as General Motors or U.S. Steel, would, in terms of number of participants, outweigh most, if not all, the small plans combined. Therefore, when the ICF study states that they chose a somewhat larger proportion of large plan sponsors compared to small plan sponsors, this would still indicate that they chose to weight by establishment rather than by number of participants. This is consistent with OPM's inappropriate recommendations to change white collar pay setting.

The Bureau of Labor Statistics and most other U.S. government statistical agencies, in trying to relay the characteristics of a retirement systems, weight those characteristics by the number of employees covered under the plans, rather than by the number of establishments that have a plan. This prevents conclusions about characteristics of retirement plans drawn from perhaps 25 small retirement systems covering a total of 100 workers from overshadowing two or three plans covering hundreds of thousands upwards to a million workers. Therefore, the statement by the ICF that "the ICF stratified the sample by plan size so that the sample would include a higher proportion of large sponsors than small sponsors" is extremely misleading in its impact upon the data.

Impact on Private Sector Representative Plans

Determination of the magnitude of "representative" retirement plans in the private sector as a percentage of payroll can and has produced widely varying statistics. Approaches that emphasize sampling based on the number of retirement plans in the private sector as opposed to the number of participants within those plans tend to produce results showing very cheap retirement systems. Conversely, analyses that consider the actual retirement systems impact on beneficiaries in the private sector, as opposed to the number of such plans in existence, result in a more generous assessment "representative" private sector retirement systems measured as a percentage of payroll. These two alternate methodologies are not only important in assessing the percentage of payroll of a given "representative" private sector retirement system but are also critical in analyzing the effects of post-retirement cost of living adjustments - whether automatic COLAs or ad hoc increases.

FAIR believes it is axiomatic that, in analyzing the retirement sector practices for nonfederal employees, we must compare retirement practices that prevail for the retiree beneficiaries of firms in the private sector that are competitive with the federal government in recruitment, hiring, and retention of employees. We conclude that in assessing the appropriate size for the new civil service retirement system to be developed for workers hired after 1/1/84, covered manditorily by Social Security, that we must seek a retirement system that will effectively allow the government to compete for and retain workers throughout their careers in the federal service.

To reiterate, the approach of the U.S. Office of Personnel Management, in its study "Technical Support in the Development of Modifications to the Civil Service Retirement System," has been to chose a sample selection methodology that considers the number of plans in determining average retirement benefits as opposed to the number of workers impacted. Because of the dominance of small plans within the private sector, as opposed to large plans, such a stratification system, though designed to include a higher proportion of plans of large sponsors compared to small sponsors, would still, in terms of consideration of the employees covered by such retirement systems, be heavily weighted towards the smaller plan systems.

This is well shown by the very comprehensive and statistically soundly drawn study entitled, "Inflation and Pension Benefits" produced for the U.S. Department of Labor by the Department of Economics and Business, North Carolina State University in August of 1983.[2] This study was based upon a random sample of private sector plans filing series 5500 forms. The purpose of the study was to ascertain the percent of increase in benefits that were received by already retired individuals between the years of 1973 and 1979 as a percentage of the overall increase in the Consumer Price Index. That is, their task was to determine the combined effect of automatic CPIs and ad hoc COLA adjustments to the CPI increase over this time period.

By plan size, the North Carolina study statistical sample showed, 84.4% of plans covered between 1 and 99 employees; 12% encompassed 100 to 499 employees; 2% had between 500 and 999 employees; 1% covered between 1,000 and 4,999 employees; 0.4% consisted of 5,000 to 9,999 employees; and finally, plans exceeding 10,000 members amounted to 0.3% of the number of plans studied in their sample (see Appendix Table A-1).[3]

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[2] Robert L. Clark, Steven G. Allen, Daniel A. Sumner (North Carolina State University), Final Report for Inflation and Pension Benefits, Department of Labor Contract No. J-9-P-1-0074, August 1983.

[3] Ibid., Table 6, page 14.

If this study had solely focused on inflation adjustments by plans between 1973 through 1979, it would have concluded that 78.4% of all the plans studied provided no COLA increases during this six year period. However, as previously noted, over 4/5 of all the plans covered only between 1 and 99 persons. The impact of such small plans upon the total number of individual retirees receiving such ad hoc COLA adjustments is miniscule.

The impact of larger plans comprised of 10,000 or more on the recipients actually receiving ad hoc COLA adjustments is very great. Therefore, if the federal government wishes to compare itself with private sector practices, it must view these practices from the point of view of the recipients, the actual past employees in a retired status, rather than strictly by the misleading statistic of the incidence of a certain occurrence by plan.

Sampling techniques must be weighted accordingly, so that the larger plans will appropriately represent their weight in the determination of the impact upon actual private sector recipients. The North Carolina University study requested and received from the Department of Labor appropriate weights for the plans included in its statistically designed sample. The net effect was that its analysis structured by recipient retirees rather than number of plans resulted in the determination that plans covering 10,000 or more workers comprised 71.2% of all pension recipients within their study. To reiterate, the 0.3% of the plans actually had an impact on 71.2% of the retiree recipients (see Appendix Table A-2).[4] Finally, and most importantly, the North Carolina University study solely considered defined benefit plans in assessing the impact of automatic and ad hoc COLAs. Inclusion of defined contribution plans is inappropriate since there is no COLA mechanism for these plans.[5]

The Office of Personnel Management's (OPM) study on COLA recapture rates indicated that the average recapture rate was 23% over the period 1974 through 1983.[6] This finding understates the conclusions of the North Carolina University study by approximately 65%. That is, the North Carolina University study found, on average, the replacement for retirees was 38% compared to that found for OPM of 23%. Further, the North Carolina researchers also determined much higher recapture rates for larger plans and for unionized plans (see Table 1 and page 12).

FAIR strongly disagrees with the findings of the OPM study. Below are enumerated four fundamental procedural and methodological errors employed in this OPM contracted out study. First, the sampling technique used by the Office of Personnel Management based upon stratification by plan size by industry as FAIR understands it is inappropriate. Second, considering the ad hoc COLA increases in plans consisting of defined contributions is mixing apples and oranges and producing totally inappropriate results. Third, the Office of Personnel Management's study found an inflation rate between 1974 and 1983 of 119%. The actual increase over this period of time amounted to 102%. Fourth, the North Carolina University researchers carefully restricted their study to payments made to already existing retirees during the period studied. In sharp contrast, the Office of Personnel Management report considered the payments by individual plans to any retirees they might have. Accordingly, newer plans in existence for relatively short periods of time would not be in a position to have granted ad hoc or automatic COLA increases to retirees since these plans in all likelihood would not yet have any retirees. FAIR concludes that all four of the procedural errors by the OPM assessment of post-retirement recaptured inflation rates would result in very substantial underestimation and warrants rejection of its findings.

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[4] Ibid., Table 4, page 11.

[5] See also Congressional Research Service, Postretirement Maintenance of Real Benefit Levels, Report No. 85-750 EPW, May 15, 1985, page 8.

[6] Towers, Perrin, Forster & Crosby, and ICF Incorporated, Technical Support in the Development of Modifications to the Civil Service Retirement System: Task I - Review of Non-Federal Retirement Practices and Costs, Contract No: OPM-18-84, August 1984.

FAIR strongly maintains that the best and most carefully designed study of ad hoc increases and automatic increases for retirees has been achieved by the North Carolina University report cited above. We note that the General Accounting Office, in its report "Features of Nonfederal Retirement Programs" issued June 26, 1984, cited this study and its conclusion that, overall, the average increases for retiree benefits amounted to 38% of the Consumer Price Index increase. The GAO summarized its findings on page 21 of their report. The results are noted in Appendix

Table 3 attached. This report concluded that plans covering 10,000 or more employees recaptured 57% of the increase in the CPI between 1973 and 1979 as shown in Table 1.

Table 1

Average Benefit Increases by Plan Size
1973-1979

Number of plan recipients	Average percentage increase	Average increase as percentage of CPI increase
1-99	3.5	5.5
100-499	14.9	23.5
500-999	13.8	21.8
1,000-4,999	9.6	15.2
5,000-9,999	21.0	33.2
10,000 and over	36.2	57.2
Overall average	24.0	37.9

Source: U.S. General Accounting Office, Features of Nonfederal Retirement Programs, GAO/OCG-84-2, June 26, 1984.

In designing a new federal retirement plan for workers hired after 1/1/84, FAIR believes that one must consider the competitive situation of the United States government in hiring workers in order to guarantee that a retirement system will be sufficient to attract and retain a high quality government workforce. In arriving at the appropriate percentage of payroll that a new retirement system should cost, the amount of recapture of COLA is a critical element in determining actuarial cost. The assumption of the *ad hoc* increase of 30%, which is used in the

Congressional Research Service and in the Hay/Huggins models to determine the actuarial cost of private sector plans, we believe, based upon the findings of the North Carolina study, are too conservative. More pertinently, a minimal percentage COLA recapture should be 38%, that found in the North Carolina study for the "average" plan. However, considerations of the competitiveness of the federal government with its private sector counterparts for a quality workforce requires that great consideration be given to the 57% recapture rate found for those plans covering 10,000 or more employees.

The Stevens-Roth Bill, S-1527, calls for a COLA formula of CPI minus 2 for the defined benefit portion of the new retirement system. Given the Social Security II-B assumptions of a 4% inflation rate, this amounts to a 50% COLA recapture rate. This 50% figure would seem to give due consideration to the 57% recapture for those plans over 10,000 employees, as found by the North Carolina University study, but with some modification related to the overall average figure of 38% recapture. FAIR, of course, urges that federal workers under the new pension system continue to receive 100% COLA protection.

Further scrutiny of the North Carolina study will reinforce the need to increase the recapture rate ascribed to "representative" private sector plans. The question, however, is if this is the figure chosen by the Stevens-Roth Bill as appropriate for federal sector workers, why then was not this 50% figure used in determining the average cost of private sector pension plans for the lower plan, average plan, and higher plan actuarial cost of private sector systems used to help determine the appropriate new federal pension cost?

The North Carolina study further allowed a breakout between unionized and nonunionized retirement systems and the effects upon their beneficiaries. Overall, the retirement benefits resulting from collectively bargained plans rose approximately 45% between 1973 and 1979, whereas those for nonunionized workers rose approximately 30%. However, when reviewing only those plans covering 10,000 workers or more, the larger plans, the plans which FAIR believes the federal government is more competitive with for hiring and retention of its workers, registered substantially higher rates. Again, unionized plans did better than nonunionized. The average benefits for noncollectively bargained plans increased by 42.2% of the increase in the Consumer Price Index. For collectively bargained plans, retiree benefits advanced 66.7% of the rise in the Consumer Price Index.

The federal government has a high degree of unionization throughout its white and blue collar employees. It is very significant that in private sector settings analogous to that of the federal government, that is with high unionization, and for large plans of 10,000 or more, which appropriately describes the federal government, the overall recapture rate for the Consumer Price Index for the defined benefit portion of retiree plans was two-thirds of the increase in the Consumer Price Index.

It is important to further note that the North Carolina University researchers felt that their findings were very conservative and enumerated at least three methodological reasons why the report could easily understate the actual recapture rate for the beneficiaries studied in their survey universe.[7]

In pricing the private sector plans, the assumed rate of increase for inflation of only 30% of the increase in the Consumer Price Index would seem to vastly understate the more realistic counterpart to the federal sector situation - **a collectively bargained union plan covering 10,000 workers or more which recovers fully two-thirds of the increase in the Consumer Price Index according to this North Carolina University study.**

The Office of Personnel Management reported that approximately 61% of all federal executive branch employees (excluding postal service) are represented by unions holding exclusive recognition in federal agencies. This percentage has remained relatively constant over the last several years. Further, of the entire nonpostal workforce, 56% were covered by agreements. In the postal service, the percentage of workers covered by contract and represented by unions is, of course, much higher, approaching 100% of workers. Further, the percentage of workers in the federal sector that are represented by unions holding exclusive recognition or that are specifically covered by collective bargaining contracts are much higher than those for the private sector.

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[7] Robert L. Clark, Steven G. Allen, Daniel A. Sumner, Final Report for Inflation and Pension Benefits, pages 2-3.

The Congressional Research Service's outstanding study entitled "Designing a Retirement System for Federal Workers Covered by Social Security," which has provided a building block for the analysis of key questions in the designing of the new federal retirement system, we believe also underestimated the value of ad hoc increases in their determination of actuarial costs of models in the private sector. We note that the Congressional Research Service and the Hay/Huggins study both used a 30% "proxy variable" for the determination of the value of postretirement inflation adjustments. On page 69 of this study, it states,

> "Benefits under the two private sector representative plans are assumed to increase annually by 30% of the increase in the Consumer Price Index - the amount found by the most comprehensive study of postretirement benefit inflation adjustments. This study showed, over six years, an overall average increase for pensions of 38% of the Consumer Price Index. Benefits under nonunion plans most likely to cover salaried employees in the private sector increased by about 30% of the increase in the Consumer Price Index, the amount selected for the representative plans."

FAIR totally concurs with the Congressional Research assessment that the North Carolina State University researchers have done the most comprehensive study of postretirement benefit inflation adjustments. We also agree with the Congressional Research Service's strong endorsement of the methodology shown by the researchers in drawing their conclusions. We disagree, however, with the Congressional Research Service's interpretation of the use of union and nonunion CPI recapture rates and their appropriateness to the federal sector.

Costing "Representative" Plans

The costing models employed by Hay/Huggins and by the Congressional Research Service have determined level of benefits in the private sector and then costed these based upon the specific actuarial assumptions appropriate to the federal sector. FAIR feels that the degree of unionization in the federal sector, standing at substantially more than twice the level of their private sector counterparts, argues strongly for the inclusion of a "proxy variable" to represent the recapture rate for inflation that is found in the private sector most closely analogous to that situation of the federal sector, that is for a highly unionized workforce. The appropriate proxy variable on this basis, according to the North Carolina University study would stand at more than twice the 30% level used in costing private sector plans.

FAIR believes that an appropriate rate to assume in costing out private sector plans can be derived by multiplying the 61% of federal workers that are unionized times the 66.7% recapture rate found by the North Carolina University report for large plans that are unionized and add to that the results of multiplying the 39% of the federal sector workers that are not unionized times the recapture rate of about 43% found for these workers in the private sector under large plans. The resulting proxy variable would by 57.5% recapture rate for inflation. Essentially identical to the actual rate shown in Table 1 on page 10.

Both the Hay/Huggins study and the Congressional Research Service study analyzing the cost of the Civil Service retirement system found the net cost to the employer to be 24.7%. The Hay/Huggins study entitled "Study of Total Compensation in the Federal, State and Private Sectors" shows that, on average, the actuarial cost for the plans analyzed are 18.3%, with the third quartile (25%) of these plans averaging 21.4%[8] and the highest 10% of these plans costing 25.1% of payroll[9].

Each of these estimates assumed a 30% recapture rate for COLA. Switching to the 57.5% recapture rate indicated above will substantially increase the percentage of payrolls that each of these plans represent. FAIR urges this Senate Committee to request that the Congressional Research Service and/or Hay/Huggins reevaluate their average, upper quartile, and highest 10% of plans given the assumption of 57.5% recapture rate for COLA. FAIR would estimate, without access to the details of the models used by Hay/Huggins and the CRS, that, at a minimum, the percentage of pay will increase by over 1.5% for the average plan upward, to about a 3% increase in actuarial cost for top 10% of plans studied.

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[8] Congressional Research Service, Designing a Retirement System for Federal Workers Covered by Social Security, Committee Print 98-17, December 1984, page 82.

[9] Hay/Huggins Company and Hay Management Consultants, Study of Total Compensation in the Federal, State and Private Sectors, Committee Print 98-16, December 4, 1984, page 53.

This increase in the actual cost of representative plans of from 1.5% to 3% of payroll is important in terms of analyzing the competitiveness of the plan that is currently being designed for future federal employees and those hired after 1/1/83 in S-1527.

FAIR urges confirmation of its estimates for the increase payroll cost of the Hay/Huggins and CRS "representative" plans for average, third quartile, and upper 10% plans of approximately 2% to 3% of payroll. **Given this confirmation, FAIR maintains that the base floor for consideration in the Senate of a new federal retirement system should move from the current 20.8% in the Stevens-Roth Bill to a value more closely aligned to a 22.8% to 23.8% range. Further, additional contributions will, according to the Congressional Research Service's level payment estimates, reduce the employer's cost by 1.1% and allow for much needed further improvements to S-1527. Further, this means that the 10% best retirement plans on average have an employer cost of 28.1% of payroll and are substantially better than the existing CSRS with an employer cost of only 24.7%.**

Federal Pay Gap - Impact on Retirement

The widely quoted Hay/Huggins findings of a 7.2% overall lag in total compensation for the federal sector workers requires substantial updating. This report issued in December of 1984 considered the total compensation relationships through fiscal year 1984. A recent GAO report entitled "Comparison of Federal and Private Sector Benefits" states that "Hay estimated that the overall deficit between federal and private sector compensation had increased from 7.2% to 9.0% or more because the federal fiscal year 1985 pay raise of 3.5% was less than the average increase in the private sector."[10] The Bureau of Labor Statistics has released the PATC data used for fiscal year 1986 pay determinations. It reports white collar pay increases ranging from 3.0% to 6.0%. Assuming the average increase to be about 4.5% and adding this to the total compensation gap of 9.0% for FY '85 would suggest in FY '86 a total compensation gap of about 13.5% since federal workers' pay is expected to be frozen in FY '86.

The federal workers' pay comparability gap has also increased. Estimating an update to the Hay/Huggins findings of a pay gap of 10.3% in FY '84 results in an FY '86 pay gap of about 16.6%.

This pay comparability gap, it must be emphasized, diminishes the value of all fringe benefits that are tied in a percentage relationship to base pay. For instance, if Congress were to establish a retirment system for newly hired federal workers that was agreed by all to be exactly equivalent to the average private sector plan for larger employers (that is the ones that the federal government competes with for employees) the percentage cost of that plan though identical to the private sector, would not afford comparability to federal workers.

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[10] General Accounting Office, Comparison of Federal and Private Sector, 9/4/85.

This can be demonstrated by analysis of the expected FY '86 pay gap of 16.6%. This gap results in the base pay for federal workers being only 85.8% of the level that should be achieved with pay comparability. If, for instance, the retirement plan were structured to be 25% of payroll, and this plan were adopted in the federal sector, the 25% when applied against a base rate pay which was only 85.8% of comparability results in a substantially diminished retirement plan dollar flow to retirees and resultant lower cost to the employer.

The net effect of this interaction is that a retirement system designed to cost 25% of payroll would, on a comparability payroll basis, cost only 21.5% of payroll. FAIR urges that deliberations to establish a fair retirement plan take into consideration the longstanding federal pay gap and its erroding impact on retirement.

Similarily, the CSRS employer cost of 24.7% of payroll is, when assessed against a comparability payroll for FY '86, worth only 21.2% of comparability payroll to the employer.

Attached to this statement are key FAIR concerns of improvements required in S-1527 to provide an adequate retirement system for all new federal and postal employees hired after 1/1/83.

We wish again to express our appreciation to the Senate Committee for allowing FAIR to submit this statement to the Committee for its consideration and its inclusion in the permanent record.

Table A-1

Percent of Plans with Persons Retired in 1973
Awarding Increases by Plan Size, 1973-78[a]

Number of Increases	Number of Recipients in 1979						
	1-99	100-499	500-999	1000-4999	5000-9999	10,000 over	All Plans
Zero	83.0	61.2	24.7	45.9	16.9	0.0	78.4
One	3.6	9.8	43.5	12.8	13.7	14.9	5.3
Two	4.8	23.7	15.3	33.8	40.4	0.0	7.7
Three	2.5	1.7	6.4	0.0	0.0	27.3	2.5
Four	1.3	0.0	0.0	0.0	0.0	34.4	1.2
Five	0.3	0.0	10.1	0.0	21.7	0.0	6.6
Six	4.5	3.5	0.0	7.5	7.3	23.3	4.4
Percent of all plans in this category	84.4	12.0	2.0	1.0	0.4	0.3	100.0

[a] Percents are calculated from weighted sample of plans.

Source: Robert L. Clark, Steven G. Allen, Daniel A. Sumner, Final Report for Inflation and Pension Benefits, Department of Labor Contract No. J-9-P-1-0074, August 1983.

Table A-2

Mean Benefit by Plan Size for Persons Retired in 1973

	Number of Recipients in Plan in 1979					
YEAR	1-99	100-499	500-999	1000-4999	5000-9999	10,000 and over
1973	$1,835	$2,073	$2,057	$2,256	$2,242	$2,149
1974	1,841	2,097	2,079	2,259	2,258	2,305
1975	1,849	2,157	2,162	2,318	2,339	2,434
1976	1,870	2,203	2,212	2,322	2,477	2,553
1977	1,880	2,222	2,216	2,421	2,530	2,659
1978	1,889	2,324	2,333	2,448	2,563	2,841
1979	1,899	2,381	2,341	2,472	2,712	2,927
Sample size	1,317	4,041	3,433	9,117	22,218	99,190

Source: Robert L. Clark, Steven G. Allen, Daniel A. Sumner, *Final Report for Inflation and Pension Benefits*, Department of Labor Contract No. J-9-P-1-0074, August 1983.

Public Employee Department AFL-CIO

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STATEMENT

of the

PUBLIC EMPLOYEE DEPARTMENT, AFL-CIO

to the

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

on

S. 1527
THE CIVIL SERVICE PENSION REFORM ACT

September 13, 1985

815 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20006 • (202) 393-2820-21

This statement is to submit the views of the Public Employee Department (PED), AFL-CIO, to the Senate Governmental Affairs Committee on S.1527, the Civil Service Pension Reform Act. The design of a new federal retirement program is a matter of the greatest concern to the PED and its 24 affiliated international unions representing nearly one and one-half million federal and postal employees.

Since passage of the Social Security Amendments of 1983, which brought newly hired federal and postal employees under the coverage of that system, the Committee and its staff have worked long and hard to master the many complex details surrounding this issue and to work with and gain the views of all affected parties. We must commend the Committee for this effort, which has been crucial to the development of a general consensus on a number of major issues.

That consensus is reflected in several provisions of S. 1527. They include: a three-tier retirement program consisting of social security, a defined benefit plan and a voluntary thrift plan; an add-on approach for integrating with social security; and using the existing fund to serve both the current system and the new plan. The bill also recognizes that special categories of employees require benefits tailored to the specific needs of their professions. We believe, however, that the proposed retirement program should be improved in a number of areas.

In judging the merits of any new federal retirement plan, the PED is guided by several basic principles. The plan must guarantee a stable and decent standard of living for federal and postal retirees. It must provide adequate incentives for attracting and retaining quality personnel and be viewed as but one part of a total federal compensation package. The plan also must provide for the fair and equal treatment of all federal and postal employees, both current and new. Achievement of these goals demands a retirement program providing benefits comparable to those of the current system.

Comparable retirement benefits can only be provided by a plan of roughly equivalent costs. S. 1527 proposes a retirement program whose employer cost is projected to be 20 percent of payroll. The current normal cost of the Civil Service Retirement System (CSRS) is 24 percent of payroll. Furthermore, the greatest portion of this 4 percent difference derives from the defined benefit plan outlined in S. 1527.

The PED firmly believes the defined benefit plan is the single most important element of the proposed retirement program. It is the most effective means for ensuring stable and secure annuities for retirees. The cost of the proposed defined benefit plan together with social security is a full 7 percent below that of the current system. A decrease of this magnitude poses a very serious threat to the retirement futures of all federal and postal employees.

A major portion of the decrease in defined benefit costs results from significant changes in cost-of-living adjustments (COLAs), the normal retirement age, and the salary years and accrual rate used to calculate benefits.

Federal pay, by all estimates including that of the President's Pay Advisor, lags behind the private sector. Total compensation, as reported by Hay/Huggins Company falls 7.3 percent behind. As a result, the current CSRS and particularly its 55 retirement age and full COLA serve as a vital recruiting tool for attracting and retaining coapable and valuable personnel. Furthermore, PED affiliated unions represent a wide range of federal employees for many of whom retirement at age 55 is, in fact, a physical necessity after dedicated long years of service to the federal government. The early retirement penalties recommended in S. 1527 are devastating for these employees and their families. Along with using the high-five salary years,as compared to the current high-three, and a one percent accrual rate, this proposal significantly reduces benefits.

Under the provisions of S. 1527, employees at all levels retiring at age 55 with 30 years of service would replace 38 percent of income if they took full advantage of the thrift plan, and only 23 percent without the thrift plan. Under the current system, 53 percent of income would be replaced. Significantly reduced replacement ratios persist even at age 62 retirement for employees earning $30,000 or less who, in reality, will be unable to make the necessary thrift plan contributions. An employee earning $30,000 retiring at age 62 would replace only 37 percent of income through social security and the defined benefit plan.

The thrift plan has been suggested as an offset for the reductions in the defined benefit plan. However, the above examples demonstrate the fact that the thrift plan, with its 3 percent cost, unfairly shifts benefits from the vast majority of federal and postal employees to high paid managers and executives. Furthermore, the thrift plan, whose investment return will depend on overall economic conditions and the vagueries of the market, cannot ensure a stable level of retirement benefits.

S. 1527 also reduces the full COLA of the current system to 2 percent below increases in the Consumer Price Index. The PED is strong in its conviction that the full COLA must be preserved so that retirees, who live on fixed incomes and have little capacity for engaging in paid employment, do not find their standard of living being vicously eroded by inflation.

There are other provisions in S. 1527 where we would suggest improvement which we have not discussed in our statement, most notably survivor, disability and special category employee benefits. PED affiliates - the American Federation of Government Employees, the National Association of Government Employees, and the National Association of Letter Carriers - addressed these areas in their testimonies before the Committee, and we urge your consideration of their recommendations.

The costs of a full COLA, a normal retirement age of 55, retention of the current formula for calculating benefits and our other recommendations might be provided for in a number of ways. First, it is our belief that the thrift plan is overly expensive and should be decreased to provide funding for improved defined benefits. We also believe that equity between employees in the current and new systems requires equal employee contributions, with the difference between social security and CSRS contributions being applied to the defined benefit plan.

Furthermore, we believe an employee contribution offers a greater degree of protection for retirement benefits. It also demonstrates the good faith of employees in their willingness to share the costs of a retirement system that truly serves not only their needs but also the needs of the federal government by offering an effective recruitment tool for attracting and retaining a valuable federal work force.

We would like to thank the Committee for its consideration of our views presented on behalf of the nearly one and one-half million federal and postal employees represented by the affiliated unions of the Public Employee Department, AFL-CIO.

STATEMENT BY

WILLIAM G. MEEKER
CITIZEN, U. S. A.

BEFORE THE

SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE AND GENERAL SERVICES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON

S. 1527, "CIVIL SERVICE PENSION REFORM ACT OF 1985"
SEPTEMBER 11, 1985

RETIREMENT BENEFITS OF EMPLOYEES FROM THE RAILROAD INDUSTRY ARE ADVERSELY AFFECTED BY FEDERAL EMPLOYMENT.

The Federal Government employs a small number of individuals recruited from the railroad industry to utilize their special technical railroad knowledge to implement vital government programs on rail transportation. These employees have made contributions to two Federal retirement systems (Railroad Retirement and Civil Service) and payments to either system were substantially equal. The contributions made to these two Federal retirement systems are deposited in the United States Treasury to remain available for eventual payment of earned retirement annuities.

However, at retirement these employees receive a significantly smaller combined retirement annuity than they would have received had their entire service been under a single system. A proposed bill to remedy this inequity is attached and the cost associated with the proposed solution is negligible.

Background

The Congress has long recognized the need to employ individuals in the Federal Service who are highly knowledgeable in the construction, maintenance, repair, and operation of railroads. Since 1911[1] the authority to employ experts to promote the safe transportation of employees and travelers upon railroads was granted in several acts to the Interstate Commerce Commission (ICC) and, subsequently, the Department of Transportation's Federal Railroad Administration (FRA) and National Transportation Safety Board (NTSB). Further, the National Mediation Board (NMB) and the Railroad Retirement Board (RRB) have been authorized to employee experts from the rail industry in order to accomplish the missions assigned those agencies. Indeed, the Congress has always believed that the employment of persons with less ability than these capable and experienced employees would doom governmental railroad programs to mediocrity [2]. Within the entire Federal Civil Service system there is now a small group of about 500 employees in these five agencies having a uniform but singular background of work experience in the railroad industry that is responsible for carrying out the multitude of programs established by the Congress.

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[1] Please see 46 Cong. Rec. 728, 730, 731 (1911) for a discussion by Senators Smith, Burkett and Lodge of the importance of selecting experienced and well qualified people from the railroad industry to be inspectors who enforce the Locomotive Inspection Act; see also 45 U.S.C. § 22.

[2] Please see, e.g., 50 Stat. 835-837 (1937); 49 U.S.C. § 26(d).

Most of the employees in this group are employed as safety inspectors at the GS-12 grade level in the FRA which, along with NTSB (accident investigators), is frequently faced with the need to recruit highly trained individuals for staffing headquarters and field assignments essential to the pursuit of agency missions. When the need to recruit arises, the agencies turn avidly to the railroad industry, the historical source of personnel trained in disciplines not available elsewhere. In reality, in every section of the country the accomplishment of agency functions is vastly facilitated by reliance on staff not trained at government expense. But those who embark on a civil service career to contribute to the improvement of railroad transportation safety by bringing their unique knowledge into public service have unknowingly disadvantaged themselves and their families in their retirement years.

While in the railroad industry these employees contributed to and, after 10 years, were vested in Railroad Retirement benefits. Then in the Federal sector, they contributed to and, after five years, were vested in Civil Service Retirement benefits. Employee contributions to both of these Federal retirement systems have been substantially the same over the years and significantly more than Social Security (see Exhibit I).

Since these employees subscribed in serial fashion to two Federal retirement programs having substantially equal contributions, these employees reasonably assumed that benefits at retirement age would be roughly equal. However, the net impact is that an employee is considerably less well off under the two-component retirement system than he would have been with service either wholly railroad oriented or entirely under the Civil Service retirement system.

Exhibit II graphically depicts the magnitude of loss inflicted upon these employees. The calculations for annuity benefits are based on a hypothetical case of an employe and spouse, both age 62, retiring at the end of 1984. The employee salary for the Railroad Retirement annuity calculations is assumed to equal the maximum earnings subject to Social Security tax in each year beginning in 1951. The Civil Service annuity is based on GS-12 schedule salary with the employee entering Federal service at Step 1 and step increases occurring in timely fashion for satisfactory performance. Each benefit computation case is based on a total of 34 years of service either in the railroad industry, the Federal sector, or various combinations of both.

Exhibit II is applicable to all FRA safety enforcement agents and NTSB railroad accident investigators at the GS-12 grade level. In every case, each employee's combined retirement benefit is less than it would have been had his or her entire career been confined to only one retirement plan. Railroad retirement laws in effect when many of these individuals accepted Federal employment have since been substantially altered and benefits have continued to erode under amended law. The well-intentioned efforts of Congress over the past several years to benefit railroad workers in their retirement years have inadvertently short-changed Federal employees with railroad retirement credit.

The 1983 Social Security amendments[3] compounded the harm to the employees having a vested interest in Railroad Retirement benefits. Because they have attained eligibility for Civil Service Retirement benefits, the Tier I Railroad Retirement benefits will be reduced after 1985. The impact of this reduction will reduce the benefits for combined service even lower than depicted in Exhibit II. When fully implemented in five years the loss in Tier I benefit will probably exceed $200 per month.

For things to have worked out this way does not seem to be what Congress had in mind. Many years ago the ICC, FRA, NTSB, NMB and RRB employees were cited in the Railroad Retirement Act[4] with respect to maintaining eligibility for Railroad Retirement benefits. As late as 1981, Congress applied partial remedy to this inequity by adding section 231b(b)(2) to the Railroad Retirement Act which specifically addresses the computation of Tier II benefits for the employees of a department or agency named in section 231(o). Still, the dedicated employees of these agencies are penalized considerably in their retirement years for their years of personal devotion to public service.

[3] 97 Stat. 76, P. L. 98-21, reprinted in 1 U.S. Code Cong. & Ad. News 65, 76-77 (98th Cong. 1st Sess. 1983)

[4] 45 U.S.C. § 231(o) (1985 Supp. Pam.)

FUNDING

Section O employees vested in both the Railroad Retirement System and the Civil Service Retirement System may recieve retirement benifits under both retirement programs. The Railroad Retirement System is funded by wages withheld from employees and by employer contributions on a payroll-hour basis. The Civil Service System similiarly withholds from employee wages and supplements this payroll taxation with obligations from the Federal Treasury - - in effect , the employers contribution. Both Retirement Systems reward long term tenure, and penalize employees with short tenure. Because most Section O employees have relatively short tenure in one or both systems, their combined benifits fall far short of those paid by one system for the same tenure. In the words of the Chief Actuary of the Railroad Retirement Board in a memorandum 5/ to a Board Member,"These employees have made substantially equal contributions under civil service and railroad retirement. At retirement, however, these employees recieve a smaller combined annuity than they would have received had their entire service been under a single system". It is this shortfall that the employees in their petition before this committee seek to redress. The language of the bill was selected after consultation with the committee of jurisdiction over Railroad retirement in both the House and the Senate. We were told by staff members that the bill would best be handled by the Post Office and Civil Service Committee and that they were hopeful that the committee would consider legislation in this Congress.We were advised that the transfer of the deposits of employee and employer contributions now residing in the Railroad Retirement system might unnecessarily complicate the proposed change. The question of interest on these long term deposits was not addressed. It will also be noted that money deposited in the Railroad Retirement System by employees and their employers is non recoverable, contrary to the existing Civil Service Retirement System that permits the withdrawal of the employee comtribution. The Railroad Retirement Board controls the disbursement of Federal funds to Railroad Retirement recipients. The Railroad Retirement Board advised those seeking to correct the shortfall that the Board was disinclined to support disbursement of its funds to another Federal System. While probably there are many alternatives to the corrective action proposed by the Section O employees , we consider this to be the best of all the alternatives. Most of the employees involved will be retiring while employed under the Civil Service Retirement System. The employees who petition for this change may not all benifit greatly from the proposed changes. A few may even find it beneficial to retire under the provisions of both of the systems as they now stand therefore we have asked that the change be elective. The majority, however, will benefit from the proposed change.

The relief proposed by this legislation will be in direct proportion to the inequity of the existing laws. Those employees who are the most greatly disadvantaged will most greatly benefit from the proposed change. Each retiring employee and his or her family, has already funded the additional benefits we now seek for them. Yet they now must bear the burden of the shortfall and inequity.

We have reviewed the Congressional Record in detail -- both of the Railroad Retirement System and the Civil Service System. Nowhere in the existing record can we find anyone speaking out against Section O employees. There is nothing in the record to indicate that Congress intentionally set out to harm Section O employees and their families. The record shows that the Congress, by establishing a Current Conmnection between the two systems, acted to protect its Federal employees with credits in the Railroad Retirement System. It was not the intent of Congress to deny these employees benifits commensurate with those received by other civil servants. We hope this committee shares that view.

The Federal Government has already received, since the initial employment of each Section O employee, adequate employer and employee contribution under both the Civil Service and Railroad Retirement Systems. The funding already exists . If there is any discreprancy, an adjustment formula could certainly be devised to correct any imbalance that may exist. In short, Section O employees and their employers already have funded the additional retirement benefits they request and should by all counts, be granted. The Railroad Retirement Board's own Chief actuary has stated, " the small number of employees involved ----- makes it certain that the effect (on Board funding) would be negible" 5/.

We urge the Committee to give swift approval of this measure as a matter of simple equity.

5/Quote from August 15,1985 memo to Member Chamberlin from Chief Actuary Solomon

Uniqueness

The Railroad Retirement Act was enacted by Congress establishing the railroad retirement system for privately owned businesses and Congress continues tomake changes to the Act to keep it viable and solvent.

The Federal Employee addressed in and affected by this proposed legislation has been recognized as being unique in his/her relationship with the Federal Government by being granted right of Current Connection in certain agencies of the Federal Government designated as section "O" agencies. Further, the uniqueness of the employees of the section "O" agencies is enhanced by the fact that before a prospective employee could be hired by the agency, that individual must have had certain experience skills obtainable only in the railroad industry. Thus previous railroad experience was necessary.

The same employee is unique in that he /she has contributed to two separate Federal Retirement systems. Thus, the section "O" employee has earned vested rights in two retirement systems under the control of one administrator, the Federal Government. Having contributed to both systems, combining the benefits will not cause additional expense to the Government because the funds for each system repose in the Federal Treasury. This contribution by the employee includes the monies contributed by the Railroad which equal the amount paid by the employee.

The section "O" employee is disadvantaged in retirement annuity because presently the retirement annuity is funded separately from each system, neither of which would amount to an amount based on the total service resulting from a combined service record.

CONCLUSION

Congress has already established a special relationship for certain Federal employees in the Railroad Retirement Act. It is only fitting that this relationship assure comparative rewards for these employees and their families in their retirement years. These employees continue to apply in Federal service the experiences that made them successful in their railroad careers. In a real sense, both jobs demand the same qualifications. Equality of retirement annuities would be achieved if service years in the railroad industry is made portable to an employee that is vested in the Civil Service Retirement program.

Such action will assure that these employees' retirement benefits will attain that of 34 years Federal service as depicted in Exhibit II, which will remove the inequities that exist today.

Precedent has been set for enacting legislation to eliminate inequities and to correct omissions with respect to the application of the Civil Service Retirement Act to a limited number of individuals.6/

The number of persons who will be affected by this legislation is comparatively very small and the cost of this legislation is insignificant. Therefore, a proposed bill to accomplish this is presented in Exhibit III and all who are concerned with this important matter are urged to actively support and endorse this much needed change.

6/ 74 Stat. 409 (1960); 5 U.S.C. §2261; please see also the legislative history for purpose and cost, reprinted in, 2 U.S.C. Cong. & Ad. News 2958-2959 (86 Cong. 2d Sess. 1960)

EXHIBIT 1

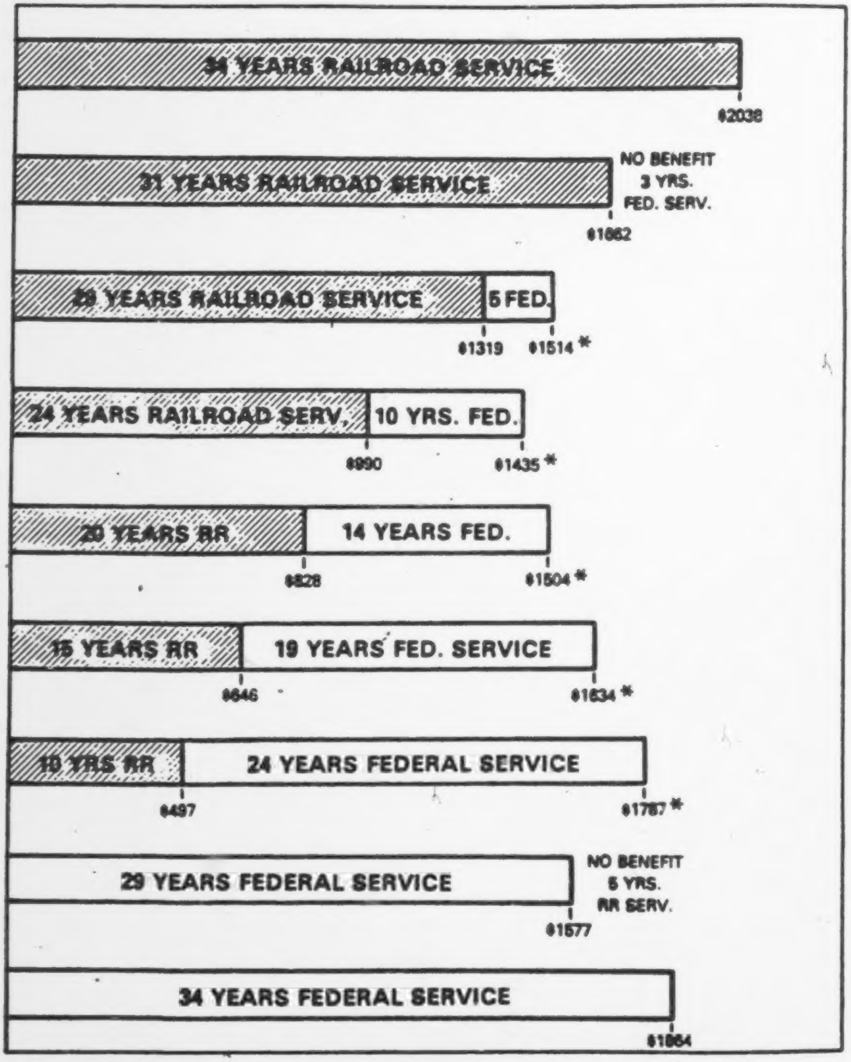
Comparative Employee Retirement Contribution Rates

Year	Railroad Retirement (%)	Civil Service Retirement (%)	Social Security (%)
1937-1940	2.750	3.5	1.000
1941-1942	3.000	3.5-5.0[1]	1.000
1943-45	3.250	5.0	1.000
1946	3.500	5.0	1.000
1947-48	5.750	5.0-6.0[2]	1.000
1949	6.000	6.0	1.000
1950-51	6.000	6.0	1.500
1952-53	6.250	6.0	1.500
1954-56	6.250	6.0	2.000
1957-58	6.250	6.5	2.250
1959	6.250	6.5	2.500
1960-61	6.750	6.5	3.000
1962	7.250	6.5	3.125
1963-64	7.250	6.5	3.625
1965	8.125-7.125[3]	6.5	3.625
1966	7.950	6.5	4.200
1967	8.650	6.5	4.400
1968	8.900	6.5	4.400
1969	9.550	6.5	4.800
1970	9.550	7.0	4.800
1971-72	9.950	7.0	5.200
1973	10.600-5.85[4]	7.0	5.850
1974-77	5.850	7.0	5.850
1978	6.050	7.0	6.050
1979-80	6.130	7.0	6.130
1981	6.650-8.65[5]	7.0	6.650
1982-83	8.700	7.0	6.700
1984	9.450	8.3	6.700

[1] Effective 6/30/42
[2] Effective 6/30/48
[3] Effective 10/1/65
[4] Effective 10/1/73
[5] Effective 10/1/81

EXHIBIT II

MONTHLY ANNUITY



PROJECTED ANNUITIES FOR SELECTED COMBINATIONS OF RAILROAD AND FEDERAL SERVICE FOR A TYPICAL FEDERAL RAILROAD ADMINISTRATION (FRA) SAFETY INSPECTOR (GS-12) & SPOUSE AT AGE 62

* (DOES NOT INCLUDE ANNUITY REDUCTIONS INCORPORATED IN THE SOCIAL SECURITY ADMENDMENTS OF 1983)

JUNE 24, 1985

EXHIBIT III

A BILL

To amend title 5, United States Code, to allow certain employees of the named Agencies in section 231 (O) of the railroad Retirement Act of 1974 to receive civil service retirementcredit for their service under the Federal Railroad retirement program.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 8332 of title 5, United States Code, relating to creditable service, is amended by adding at the end thereof the following new subsection:

"(n) Upon application to the Office of Personnel Management, any individual who, on December 31, 1983 was an employee of an Agency named in section (O) of the Railroad Retirement Act of 1974 (45 U.S.C. p231) shall be allowed credit for any period of service before December 31, 1983 which is creditable under the Railroad Retirement Act of 1974.

Sec. 2. Paragraph (6) of section 8334 (g) of title 5, United States Code, relating to service for which deposits are not required, is amended by striking out "section 8332(1)" and inserting in lieu thereof "subsections (1) and (n) of section 8332".

○